



BLOCK 1	
INTRODUCTION TO STRATEGIC MANAGEMENT	5

Unit 1	Concept of Strategy	9
Unit 2	Strategic Framework	23
Unit 3	Strategy in Global Context	43

BLOCK 2	
ENVIRONMENTAL ANALYSIS	59

Unit 4	External Environmental Analysis	63
Unit 5	Competitive Analysis	79
Unit 6	Internal Environmental Analysis	95

BLOCK 3	
FORMULATION OF STRATEGY	113

Unit 7	Business Level Strategy	17
Unit 8	Competitive Strategy	130
Unit 9	Corporate Level Strategy	147

BLOCK 4	
STRATEGY IMPLEMENTATION AND CONTROL	169

Unit 10	Implementation- Behavioural Dimensions	173
Unit 11	Corporate Governance	190
Unit 12	Control	203
Unit 13	Evaluation	218

COURSE DESIGN AND PREPARATION TEAM

Prof. K Ravi Sankar
Director,
School of Management Studies,
IGNOU, New Delhi

Dr Monica Sainy
Shri Vaishnav School of Management
Indore

Prof. U M Amin
Former Director
CMS, Jamia Milia Islamia
New Delhi

Prof. G Subbayamma
School of Management Studies,
IGNOU, New Delhi

Prof. Arindam Banik
IMI, Qutab Institutional Area,
New Delhi

Prof. Srilatha
School of Management Studies,
IGNOU, New Delhi

Prof. Ashish Bajpai
IMS, Banaras Hindu University
Varanasi

Prof. Anjali Ramteke
School of Management Studies,
IGNOU, New Delhi

Prof. Tanuj Nandan
School of Management Studies
Motilal Nehru National Institute of Technology
Prayagraj

Prof. Nayantara Padhi
School of Management Studies,
IGNOU, New Delhi

Prof. Ram Singh
IIFT, New Delhi

Sh. T V Vijay Kumar
School of Management Studies,
IGNOU, New Delhi

Prof. Sumita Dave
Amity Business School
Amity University, Raipur
IIM, Indore

Dr. Leena Singh
School of Management Studies,
IGNOU, New Delhi

Dr. Manjari Agarwal
School of Management Studies
Uttarakhand Open University
Haldwani

Prof. Neeti Agrawal
(Course Coordinator & Course Editor)
School of Management Studies,
IGNOU, New Delhi

Dr. Sweta Srivastava Malla
IIFT, New Delhi

* Some relevant portions of the material has been extracted from the old course
MS-11 : Strategic Management

PRINT PRODUCTION

Mr. Tilak Raj,
Assistant Registrar
MPDD, IGNOU, New Delhi

February, 2022

© Indira Gandhi National Open University, 2022

ISBN :

All rights reserved. No part of this work may be reproduced in any form, by mimeography or any other means, without permission in writing from the Indira Gandhi National Open University. Further information on the Indira Gandhi National Open University courses may be obtained from the University's office at Maidan Garhi, New Delhi 110068.

Printed and published by **The Registrar**, MPDD, IGNOU, New Delhi on behalf of the Indira Gandhi National Open University, New Delhi.

Laser Typesetting : Akashdeep Printers, 20-Ansari Road, Daryaganj, New Delhi-110002

Printed at :

MMPC 0012: STRATEGIC MANAGEMENT

When we talk about the functions of management, we find that strategy is one of the most significant areas of decision-making in any organization. All the management functions, therefore, depend on strategic management. In short it can be said that strategic management is an art as well as a science of formulating, implementing and evaluating the decisions so as to enable the organization to achieve its goals. Strategic Management comprises of three broad activities, namely: strategic analysis, strategic formulation and strategic implementation. All the three are interrelated. Strategic analysis is the foundation for formulating strategies and basically comprises of the study of business environment as a whole. There are forces of different kinds and complexities, which influence organizations and their business. The basic aim of strategic management is that a manager must adjust strategies to reflect the environment in which the business operates. Once a particular strategy is formulated, the implementation part comes into existence. Implementation includes all those actions which are necessary to put the strategy into practice. This is why implementation is said to be more important than the formulation. After the strategy is brought into practice, it needs to be controlled and evaluated to assess its efficacy for the organization. This course focuses on all these aspects.

The course is divided into four blocks and has 13 units in all. The course outline is given below.

Block 1 : Introduction to Strategic Management

- Unit 1 : Concept of Strategy
- Unit 2 : Strategic Framework
- Unit 3 : Strategy in Global Context

Block 2 : Environmental Analysis

- Unit 4 : External Environmental Analysis
- Unit 5 : Competitive Analysis
- Unit 6 : Internal Environmental Analysis

Block 3 : Formulation of Strategy

- Unit 7 : Business Level Strategy
- Unit 8 : Competitive Strategy
- Unit 9 : Corporate Level Strategy

Block 4 : Strategy Implementation and Control

- Unit 10 : Implementation- Behavioural Dimensions
- Unit 11 : Corporate Governance
- Unit 12 : Control
- Unit 13 : Evaluation

The learning objectives of this course are to understand the:

- Meaning and concept of Strategic Management;
- Strategic Management Process;
- Need for strategy in the global context;
- Internal and external environmental analysis;
- Role of competitive analysis in formulation competitive strategies;
- Various levels of strategies and their importance;
- Implementation, control and evaluation of formulated strategy;
- Concept of corporate governance.



ignou
THE PEOPLE'S
UNIVERSITY



BLOCK 1

**INTRODUCTION TO
STRATEGIC MANAGEMENT**

Pignou
THE PEOPLE'S
UNIVERSITY

BLOCK 1 INTRODUCTION TO STRATEGIC MANAGEMENT

This block consists of three units and each unit gives a brief understanding of the concepts of strategic management.

Unit 1: Concept of Strategy gives the meaning, nature and essence of strategy and the relationship of strategy with the policies, programmes and rules of the organization. Further, the different levels of strategy are discussed and the importance of strategy in the corporate world is discussed.

Unit 2: Strategic Framework discusses in detail the different aspects of strategic intent, which includes vision, mission, business, and objectives. In this unit we get an understanding of the core values and core purpose and their importance. As we move further, we find that concepts of strategy formulation, implementation and evaluation are discussed. In all, this unit gives a brief understanding of the process of strategic management.

Unit 3: Strategy in Global context discusses the strategic perspective in the global context. This unit gives a bird's eye view of the concepts related to global Strategic Management.

Overall this block introduces the concept of strategic management and the process of strategic management.

ignou
THE PEOPLE'S
UNIVERSITY

UNIT 1 CONCEPT OF STRATEGY

Objectives

After reading this unit you should be able to:

- Define strategy and understand its meaning;
- Explain the relationship of strategy with that of policy and tactics;
- Differentiate between different levels of strategy;
- Know the importance of strategy.

Structure

- 1.1 Introduction
- 1.2 Meaning of Strategy
- 1.3 Features of Strategy
- 1.4 Strategic Management: Concept
- 1.5 Strategy vs. Policy
- 1.6 Strategy vs. Tactics
- 1.7 Levels of Strategy
- 1.8 Importance of Strategy
- 1.9 Summary
- 1.10 Key Words
- 1.11 Self Assessments Questions
- 1.12 References and Further Readings

1.1 INTRODUCTION

The top management of an organization is concerned with selection of a course of action from among different alternatives to meet the organizational objectives. The process by which objectives are formulated and achieved is known as strategic management and strategy acts as the means to achieve the objectives. Strategy is the grand design or an overall 'plan' which an organization chooses in order to move or react towards the set objectives by using its resources. An organization is considered efficient and operationally effective if it is characterized by coordination between objectives and strategies. Strategy helps the organization to meet its uncertain situations with due diligence and without an effective strategy, the organization is like a ship without a rudder. There are different concepts which actually describe strategy. There is no one definition of strategy as it changes with the needs and requirements of the organization. In this unit we will learn different aspects of strategy.

1.2 MEANING OF STRATEGY

The strategy is defined as a plan deployed at each level of management for the attainment of objective and realization of long-term goals of the organization. It

is a set of coherent actions which are performed in order to gain a sustainable competitive advantage. The term strategy was primarily used in military and was later adapted to the field of business and management. It was derived from a Greek word 'Strategos', where 'Stratos' means army and 'agos' implies to lead.

In management, the concept of strategy is taken in broader terms. Strategies are used to acquire a competitive advantage over others in any field. There can be general or specific strategies depending upon the situation. Organization deploys strategies for several purposes such as for satisfying customers, surviving in the market, expanding the business, improving market share, increasing profitability and ultimately to attain objectives of the organization. According to **Glueck**, **"Strategy is the unified, comprehensive and integrated plan that relates the strategic advantage of the organization to the challenges of the environment and is designed to ensure that basic objectives of the enterprise are achieved through proper implementation process."**

It lays stress on the following:

- Unified comprehensive and integrated plan;
- challenges of environment;
- proper implementation for achieving basic objectives.

Strategies are used as a response to the change in environment. They are adopted in accordance with the strength and weakness of the organization. The main aim of framing strategies is to seek out the opportunities favoured by the external environment and mitigate the threats simultaneously. The organization can adopt strategies to achieve the desired position in the industry. There are number of definitions given by different experts at different point of time. One such definition relates strategy to its environment. It says "Strategy is organization's pattern of response to its environment over a period of time to achieve its goals and mission."

This definition lays stress on the following:

- Organization's pattern of response to its environment;
- Achieving goals and mission.

However, various experts do not agree about the precise scope of strategy. Lack of consensus has led to two broad categories of definitions: strategy as action inclusive of objective setting and strategy as action exclusive of objective setting.

Strategy as Action Inclusive of Objective Setting

In 1960s, Chandler made an attempt to define strategy as "the determination of basic long term goals and objective of an enterprise and the adoption of the courses of action and the allocation of resources necessary for carrying out these goals."

This definition provides for three types of actions involved in strategy:

- Determination of long term goals/objectives;
- Adoption of course of action;
- Allocation of resources.

This is another view in which strategy has been defined in a way in which the organization, reacting to its environment, deploys its principal resources and siphons its efforts in pursuit of its purpose. Michael Porter has defined strategy as “Creation of a unique and valued position involving a different set of activities. The organization that is strategically positioned performs different activities from rivals or performs similar activities in different ways.”

The people who believe this version of the definition call strategy a unified, comprehensive and integrated plan relating to the strategic advantage of the organization to the challenges of the environment.

After considering both the views, strategy can simply be put as management’s plan for achieving its objectives. It basically includes determination and evaluation of alternative paths to an already established mission or objective and eventually, choice of best alternative to be adopted.

1.3 FEATURES OF STRATEGY

As we now know that strategy is an integral part of any managerial activity. At this point of time we need to know the basics of strategy before we move further. To explain strategy we usually say that it is a plan of action. This explanation tries to tell about the future course of action of strategy. This involves different parameters which actually defines the strategy. Mintzberg (2005) has given 5 Ps for strategy which integrates the past, present and the future course of action. These 5Ps are:

1. Pattern
 2. Plan
 3. Position
 4. Perspective
 5. Ploy
1. **Pattern:** When we say that strategy is a **pattern**, we meant to say that the organization has been consistent in following a particular course of action e.g. an organization which markets responsive products usually follows a high-end-strategy and this pattern is repetitive in nature. Pattern shows the past behaviours. This becomes the **realized strategy**.
 2. **Plan:** When we see strategy as a **plan**, it means preparing for future or looking ahead. This becomes an **intended strategy**. Usually the organizations witness quite a contrast between the intended strategy and the realized strategy.

Here, if the intended strategy becomes a realized strategy then it becomes a **deliberate strategy** otherwise it is termed as unrealized strategy. In certain cases strategy becomes an emergent strategy where the plans are followed but in steps. For e.g. an organization plans to diversify but it does not take the decision of diversification at one go instead it moves towards diversification in a step-wise manner.

3. **Position:** In certain cases, especially in the niche markets, strategy is a **position**. For e.g. fast food chain wants to locate particular products in specific markets. Michael porter has discussed the concept of positioning there by increasing the value of organization quite categorically.
4. **Perspective:** Strategy is a **perspective** which means that strategy looks at the vision of the organization. In position it looks at the external environment whereas in perspective it looks at the internal environment.
5. **Ploy:** This is another way of looking at strategy. Ploy is the tactic used by the organization to outwit its competitors. These five P's of strategy explain the concept of strategy under different situations. Therefore strategy:
 - Sets direction;
 - focuses effort
 - defines the organization
 - provides consistency.

The different features of strategy are depicted in figure 1.1.

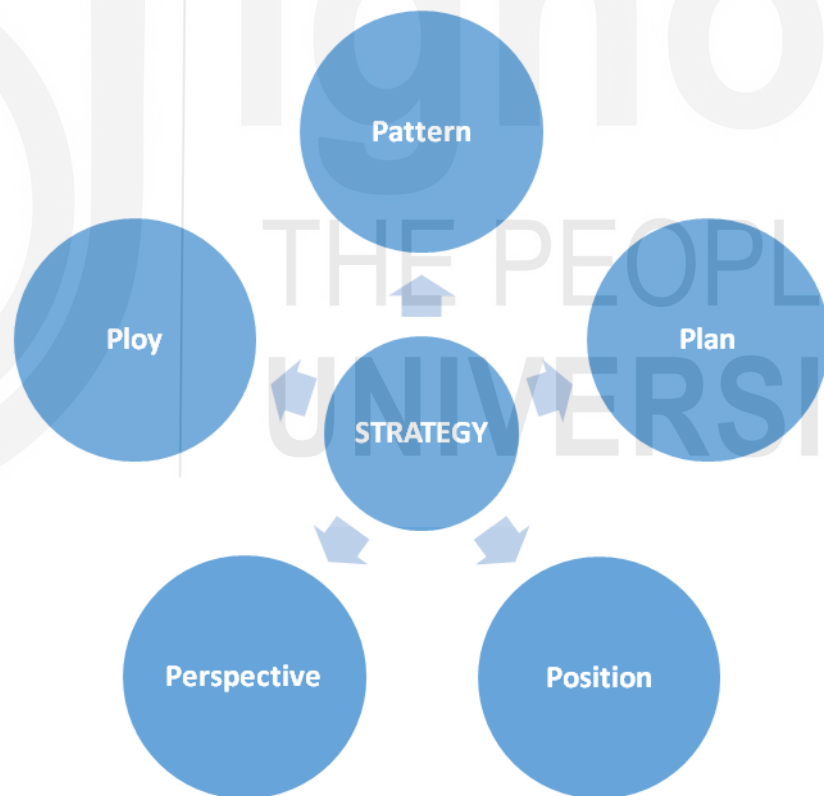


Figure 1.1: Features of Strategy

NATURE OF STRATEGY

We learnt how strategy can be perceived in different ways. The various views summarize the nature of strategy which is as follows:

- Strategy involves both organization and environment and both are inseparable;
- Strategy is like a Mosaic. It cannot be structured, programmed, routine and repetitive.

- Strategy is futuristic in nature.
- Strategy is a combination of content and process both.
- Strategies are formulated at different levels.
- Strategy is an integration of concept with analysis for decision making.

Therefore, we can say that strategy as a whole is the combination of 5 P's which can be customized as per the requirement of the organization. The purpose of strategy is to determine and communicate a picture of enterprise through a system of major objectives and policies. Strategy is concerned with a unified direction and efficient allocation of an organization's resources. A well-made strategy guides managerial action and thought. It provides an integrated approach for the organization and aids in meeting the challenges posed by environment.

1.4 STRATEGIC MANAGEMENT: CONCEPT

We now know that strategy is a series of steps based on an organization's vision, mission, goals and objectives. Strategic Management is concerned with the effective deployment of business strategies for the achievement of the organizational objectives for the purpose of reaching the desired goal. Strategic management involves making strategic decisions at various levels of the organization. However, strategic decisions are taken at the top level of management and then transferred to lower level management. These decisions are related to moving from the present state of an organization to a future state. It basically develops a framework within which an organization functions. In other words, strategic management defines organizational capability, forms of value addition and the purpose of the existence of an organization.

Strategic management:

- is a medium and long-term process;
- begins with the formulation of a desirable future position for the organization, followed by decisions regarding what is at the core of the organization;
- setting up targets for reaching the future state;
- enables an organization to obtain an edge over its competitors in the market by analyzing the resources available with the organization;
- is formulating strategies for effective and efficient utilization of resources;
- matches the organizational capabilities with the environmental opportunities;
- is futuristic and organization wide process.

Therefore, we can say that strategic management is the process of formulation and implementation of strategies lying within the boundaries of the organizational resources in response to the environmental opportunities and threats so as to achieve sustainable competitive advantage over competitors.

Activity 1

Discuss the nature of strategy with respect to 5Ps.

.....

.....

.....

.....

1.5 STRATEGY VS POLICY

We have understood the concept of strategy. Now we will learn the difference between strategy and policy. In earlier times when strategy was not in organized form, the concept of business policy was more in use. Strategy was often used as a synonym of policy despite the fact that both are not similar in nature. Strategy is a plan of action whereas policy is a set of rules and procedures. Policy is a part of strategy therefore at times it becomes important to differentiate the two.

Table 1.1 gives a birds' eye view of the difference between strategy and policy based on certain parameters.

Table 1.1: Difference between Strategy and Policy

Basis of differentiation	Strategy	Policy
Concept	Strategy is a plan of action for achieving organizational goals.	Policy is the guidelines for certain actions and decision to be taken part of the organization.
Specification	Plan of action	Principles of action.
Nature	Flexible	Fixed barring exceptions
Application	Related to decision making of the organization for future situations; or situation which may occur in future.	Related to the rules of the organization for the repetitive activities; governs and controls managerial action.
Direction	Action oriented	Decision oriented
Formulation	Top and middle level management	Top level Management
Coverage	External environment	Internal environment
Description	Plan of action use to achieve the goals	Set principles description do's and don'ts. It is considered to be a mini mission statement.

It is very important to understand role that policy has to be interpreted with strategy for effective implementation. Policy can be general or specific, organizational or functional, written or implied depending on the need of the organization. For example, when the performance of two employees is similar, the promotional policy may require the promotion of the senior employee and hence s/he would be eligible for promotion. Strategy has often been used as a synonym of policy. However, both are different and should not be used interchangeably. Policy is the guideline for decisions and actions on the part of subordinates. It is a general statement of understanding made for achievement of objectives.

Strategies and policies both are the means towards the end. In other words, both are directed towards meeting organizational objectives. Strategy is a rule for making decision while policy is contingent decision.

1.6 STRATEGY VS TACTICS

Sun Tzu in his book 'The Art of War' wrote "Strategy without tactics is the slowest route to victory. Tactics without Strategy is the noise before the defeat." This shows the importance of tactics in accomplishing a specific Strategic decision. Strategies is on one end of the organizational decisions spectrum while tactics lie on the other end.

Carl Von Clausewitz, a Prussian army general and military scientist defines military strategy as 'making use of battles in the furtherance of the war and the tactics as "the use of armed forces in battle"'. A few points of distinction between the two are as follows:

- Strategy determines the major plans to be undertaken while tactics is the means by which previously determined plans are executed.
- The basic goal of strategy according to military science is to break the will of the army, deprive the enemy of the means to fight, occupy territory, destroy or obtain control of resources or make them surrender. The goal of tactics is to achieve success in a given action and this forms one part of a group of related military action.
- Tactics can be delegated to all the levels of an organization while strategic decisions cannot be delegated too low in the organization.
- Strategy is formulated in both a continuous as well as irregular manner. The decisions are taken on the basis of opportunities, new ideas etc. Tactics is determined on a periodic basis by various organizations. A fixed time table may be made for following tactics.
- Strategy has a long term perspective and occasionally it may have short term duration. Thus, the time horizon in terms of strategy is flexible but in case of tactics, it is short run and definite.
- The decisions taken as part of strategy formulation and implementation have a high element of uncertainty and are taken under the conditions of partial ignorance. In contrast tactical decisions are more certain as they work upon the framework set by the strategy. So the evaluation of strategy is difficult than the evaluation of tactics.

- Since an attempt is made in strategy to relate the organization with its environment, the requirement of information is more than that required in tactics. Tactics uses information available internally in an organization.
- The formulation of strategy is affected considerably by the personal values of the person involved in the process but the same is not the case in tactic implementation.
- Strategies are the most important factor of organization because they decide the future course of action for organization as a whole. On the other hand, tactics are of importance only with specific part of the organization.

Table 1. 2 gives the levels of comparison between strategy and tactics.

Table 1.2: Comparison of Strategy and Tactics

Basis of Comparison	Strategy	Tactics
Goal	Control of resources	Achieve success
Delegation	Top and middle	All levels
Formulation	Flexible and continuous	Fixed and periodic
Perspective/time frame	Long term	Short term
Level of certainty	High	Low
Environment	External	Internal

An effective strategy is based on the strengths of the organization and also creating strengths of the organization. When it comes to creating strengths of the organization, then the tactics comes into play. For e.g. the marketing strategy of an organization is to improve its performance on the social media, Then the tactics of the organization should be using an appropriate social media so as to communicate the message in the most effective way possible. Therefore, it is important that strategy and tactics should align themselves in such a way so as to make the strategy effective.

Activity 2

1. Choose the organization of your choice and list the policies of any organization and also state the strategies it undertook.

.....

.....

.....

.....

2. Distinguish between strategy and tactics.

.....

.....

3. Distinguish between strategy and policy.

1.7 LEVELS OF STRATEGY

It is believed that strategic decision making is the responsibility of top management. However, it is considered useful to distinguish between the levels of operation of the strategy. Strategy operates at different levels. These are:

- Corporate Level
- Business Level
- Functional Level

There are basically two categories of organizations- one, which have different businesses organized at different directions or product groups known as profit centres or strategic business units (SBUs) and other, which consists of organizations which are single product organizations. The example of first category can be that of an organization which is a highly integrated producing textile, yarn, and a variety of petro chemical products and the example of the second category could be an organization which is engaged in the manufacturing and selling of heavy commercial vehicles. The SBU concept was introduced by General Electric Organization (GEC) of USA to manage product business. The fundamental concept in the SBU is the identification of discrete independent product/ market segments served by the organization.

Features of SBU

- Because of the different environments served by each product, a SBU is created for each independent product/ segment.
- Each and every SBU is different from another SBU due to the distinct business areas (DBAs) it is serving.
- Each SBU has a clearly defined product/market segment and strategy. It develops its strategy according to its own capabilities and needs with overall organizations capabilities and needs.
- Each SBU allocates resources according to its individual requirements for the achievement of organizational objectives.
- As against the multi-product organizations, the single product organizations have single Strategic Business Unit. In these organizations, corporate level strategy serves the whole business.

- The strategy is implanted at the next lower level by functional strategies. In multiple product organization, a strategy is formulated for each SBU (known as business level strategy) and such strategies lie between corporate and functional level strategies.

The three levels are explained below.

Corporate level strategy

At the corporate level, strategies are formulated as per the policies of the organization.

Characteristics

- These are value oriented, conceptual and less concrete than decisions at the other two levels.
- These are characterized by greater risk, cost and profit potential as well as flexibility.
- Mostly, corporate level strategies are futuristic, innovative and pervasive in nature.
- They occupy the highest level of strategic decision making and cover the actions dealing with the objectives of the organization. Such decisions are made by top management of the organization. The example of such strategies includes acquisition decisions, diversification, structural redesigning etc.
- The board of Directors and the Chief Executive Officer are the primary groups involved in this level of strategy making.
- In small and family owned businesses, the entrepreneur is both the general manager and chief strategic manager.

Business level strategy

The strategies formulated by each SBU to make best use of its resources given the environment it faces, come under the gamut of business level strategies.

Characteristics

- At such a level, strategy is a comprehensive plan providing objectives for SBUs, allocation of resources among functional areas and coordination between them for achievement of corporate level objectives.
- These strategies operate within the overall organizational strategies i.e. within the broad constraints and policies and long term objectives set by the corporate strategy.
- The SBU managers are involved in this level of strategy.
- The strategies are related with a unit within the organization.
- The SBU operates within the defined scope of operations by the corporate level strategy and is limited by the assignment of resources by the corporate level.

- Business strategy relates with the “how” and the corporate strategy relates with the “what”.
- Business strategy defines the choice of product or service and market of individual business within the organization. The corporate strategy has impact on business strategy.

Functional level strategy

This strategy relates to a single functional operation and the activities involved therein. This level is at the operating end of the organization.

Characteristics

- The decisions at this level within the organization are described as tactical.
- The strategies are concerned with how different functions of the enterprise like marketing, finance, manufacturing etc. contribute to the strategy of other levels.
- Functional strategy deals with a relatively restricted plan providing objectives for specific function, allocation of resources among different operations within the functional area and coordination between them for achievement of SBU and corporate level objectives.

Sometimes a fourth level of strategy also exists. This level is known as the operating level. It comes below the functional level strategy and involves actions relating to various sub functions of the major function. For example, the functional level strategy of marketing function is divided into operating levels such as marketing research, sales promotion etc.

Three levels of strategies have different characteristics as shown in the table 1.3.

Table 1.3: Strategic Decisions at Different Levels

DIMENSIONS	LEVELS		
	CORPORATE	BUSINESS	FUNCTIONAL
TYPE OF DECISION	CONCEPTUAL	MIXED	OPERATIONAL
Impact	Significant	Major	Insignificant
Risk Involved	High	Medium	Low
Profit Potential	High	Medium	Low
Time Horizon	Long	Medium	Low
Flexibility	High	Medium	Low
Adaptability	Insignificant	Medium	Significant

1.8 IMPORTANCE OF STRATEGY

With the increase in the pressure of external threats, organizations have to make clear strategies and implement them effectively so as to survive. There have

been organizations that have completely become extinct and some organizations which were non-existent earlier and now have become the market leaders. The basic factor responsible for differentiation has not been governmental policies, infrastructure or labour relations but the type of strategic thinking that different organizations have shown in conducting the business. This is where the importance of strategy comes into picture.

Strategy provides various benefits to its users. These are:

- Strategy helps an organization to take decisions on long range forecasts.
- It allows the organization to deal with a new trend and meet competition in a effective manner.
- Strategy helps the management to be flexible and meet the uncertain situations.
- Efficient strategy formulation and implementation result into financial benefits to the organization in the form of increased profits.
- Strategy provides focus in terms of organizational objectives and thus provides clarity of direction for achieving the objectives.
- Organizational effectiveness is ensured with effective implementation of the strategy. It gets managers into the habit of thinking and thus makes them, proactive and more conscious of their environment.
- It provides motivation to employees as it paves the way for them to shape their work in the context of shared corporate goals and ultimately they work for the achievement of these goals.
- Strategy formulation & implementation gives an opportunity to the management to involve different levels of management in the process.
- It improves corporate communication, coordination and allocation of resources.

With all the benefits listed above, it is quite clear that strategy forms an integral part of an organization and is the means to achieve the end in an efficient and effective manner.

Activity 3

1. Identify the benefits which an organization may have after implementing strategies.

.....

.....

.....

.....

2. Distinguish corporate level strategy and business level strategy.

.....

.....

.....

.....

3. State three benefits of strategy.

.....

.....

.....

.....

1.9 SUMMARY

In this unit we introduced the concept of strategy. Strategy is the conscious and rational management exercise which involves defining and achieving organizations' objectives and implanting its mission. Strategy is a major course of action and is a blend of internal & external factors and is particular to a specific situation. It is dependent on environmental variables and is futuristic in nature. Strategy is a series of action plans which are adopted by an organization to achieve the ultimate goal of profitability, growth and survival. Strategy is based on 5Ps i.e. pattern, plan, position, perspective and ploy and is operational at three levels -Corporate level, Business level and Functional level. Strategies are lifeblood of business activities.

1.10 KEYWORDS

Effectiveness	- The ability to complete a job within the given time-frame while using limited resources.
Efficiency	- The ability to use less resources or minimizing the waste of resources while performing any job.
Strategy	- A unified, comprehensive and integrated plan that relates the strategic advantage of the organization to the challenges of the environment.
Policy	- Guideline for decisions and actions on the part of subordinates and is a general statement of understanding made for the achievement of objectives.
Tactics	- It is the means by which previously determined plans are executed.
Rules	- A principle to which an action or a procedure conforms or is intended to conform.

1.11 SELF-ASSESSMENT QUESTIONS

- 1) What do you mean by strategy? Explain the nature of strategy.
- 2) “Strategy is synonymous with policies” Comment on the statement.
- 3) What are the various levels at which a strategy may exist?
- 4) Discuss the importance of strategy?

1.12 REFERENCES AND FURTHER READINGS

Henry, A. E. (2018). *Understanding Strategic Management* (3rd ed.). Oxford, United Kingdom: Oxford University Press.

Haberberg, A. & Rieple, A. (2010). *Strategic Management* (2010ed.). New York: Oxford University Press.

Kazmi, A. (2008). *Business Policy and Strategic Management* (3rd ed.). Delhi: Tata Mcgraw Hill Publishing Co, Ltd.

Kishor, R. M. (2016). *Strategic Management* (2015 ed.). Delhi: Taxmann publication.

Mintzberg, H., Ahlstrand, B. & Lampel, J. (2005). *Strategy Safari* (2005 ed.). New York: Free Press.

Nag, A. (2011). *Strategic Management* (1st ed.). Delhi: Vikas publishing house.

Prasad, L.M. (2002). *Business Policy: Strategic Management*. Delhi: Sultan Chand & Sons.

Shrivastava, R. M. (2017). *Management Policy and Strategic Management* (3rd ed.). Mumbai: Himalaya Publication House.

UNIT 2 STRATEGIC FRAMEWORK

Objectives

After reading this unit, you should be able to:

- Understand the process of strategic management;
- Get acquainted with the concept of vision, mission and objectives;
- Acquaint yourself with the process of strategic formulation, implementation and control.

Structure

- 2.1 Introduction
- 2.2 Strategic Management Process
- 2.3 Strategic Intent
- 2.4 Strategic Analysis
- 2.5 Strategy Formulation
- 2.6 Choice of Strategy
- 2.7 Strategic Implementation
- 2.8 Strategic Evaluation and Control
- 2.9 Summary
- 2.10 Keywords
- 2.11 Self-Assessment Questions
- 2.12 References and Further Readings

2.1 INTRODUCTION

Strategic management is the process of developing strategies based on organizational directions. These organizational directions are derived from the strategic intent of an organization. The hierarchy of strategic intent lays the foundation for strategic management process. The process of establishing the hierarchy of strategic intent is very complex. In this hierarchy, the vision, mission, business definition and objectives are established. Strategies are involved in the formulation, implementation and evaluation of process. Formulation of strategies is possible only when strategic intent is clearly set up. This step is mostly philosophical in nature. It will have long term impact on the organization. The vision and mission of an organization lead the path of organizational functions. Strategies are formulated based on the strategic intent. The success of the strategies depends on effective implementation. Strategies so implemented require continuous evaluation and control to make sure that the objectives of the organization are achieved as planned.

In the context of an organization engaged in strategy formulation and implementation, the substantive dimension deals with the determination of strategy or set of strategies and procedural dimension deals with placing a strategy into operation with clarity about the employees responsible for a particular task. The logic of a process is that its particular elements are undertaken in a sequence over a period. The process of strategy includes a number of elements. The process can be defined as a set of management decisions and actions which determines the long run direction and performance of the organization. It is a dynamic and continuous process. However, there are two problems in identifying and sequencing the elements. These are:

- i) There is no unanimity among various authors about the elements and their interaction.
- ii) The sequence of the elements varies.

Both these problems highlight the complexity of a strategic process. The process includes definition of organizational vision, mission and objectives, environmental analysis, identification and evaluation of strategic alternatives, making a choice, implementing it and evaluating and controlling the strategy.

2.2 STRATEGIC MANAGEMENT PROCESS

Strategic management process involves creating a strategic intent, conducting an environmental analysis, formulating and implementing the strategies. It is the process which helps the managers in strategic decision making in order to achieve the overall organizational goals. Strategic management process involves formulating strategies based on organizational competencies and vision and mission of the organization. It is a continuous process and is related to the following activities:

- Envisioning a desirable future position for the organization;
- Stating the base values of the organization;
- Analysis of external as well as internal environment;
- Linking the organizational strengths with environmental opportunities;
- Taking decisions regarding resource allocation;
- Formulating alternative strategies and selecting the most feasible strategy;
- Implementing the selected strategy;
- Evaluating the implemented strategy and exercising review and control;
- Taking corrective measures, if necessary;

Figure 2.1 shows the strategic management process.

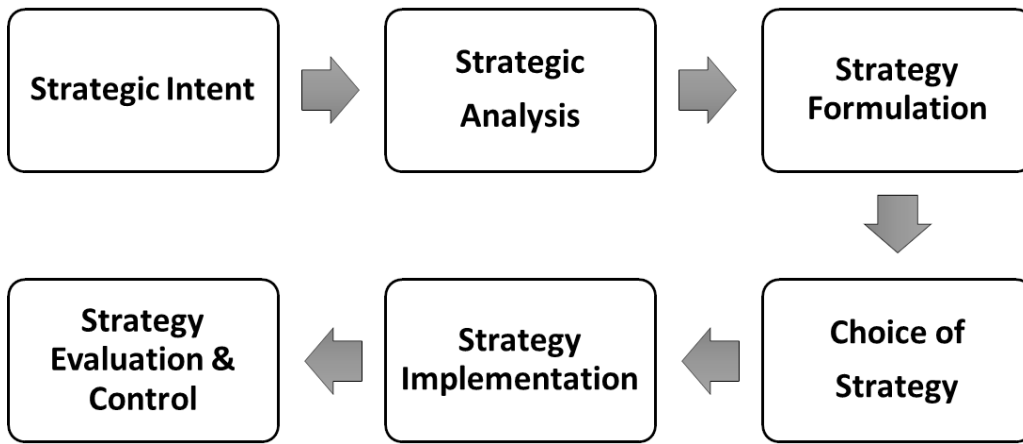


Figure 2.1: Process of Strategic Management

We will discuss each element in subsequent sections.

Activity 1

1. Explain the concept of strategy.

.....

.....

.....

.....

.....

2. List the different elements in the strategic management process?

.....

.....

.....

.....

.....

2.3 STRATEGIC INTENT

Strategic intent is the direction which an organization adopts to drive its operations in a particular manner to achieve the expected outcomes. It was a term formulated by Hamel and Prahalad in 1989 and is concerned with the allocation of available resources, organizing the individual efforts of employees, collaborating with the workforce in a team and motivating them towards organizational goals. The strategic intent of an organization consists of vision, mission, objectives and goals. It is the basic strategic input of the strategic management process. It explains the purpose for which an organization exists and what an organization as a whole wants to achieve.

The strategic intent of an organization follows a hierarchy as shown in figure 2.2.



Figure 2.2: Hierarchy of strategic intent

These are explained in detail as follows:

VISION

A vision of an organization is the expectation that the organization wants to fulfill.

Features

- It encompasses a state or position which an organization wants to achieve in future.
- It showcases a futuristic picture of an organization.
- It acts as a guide for an organization. An organization which has a formally written vision is able to concentrate better on its functional abilities.
- An organizational vision depicts the desirable future position that an organization wants to achieve in the coming years.
- It involves movement from the current position to the future position.
- A vision is a long-term concept as it remains the same for several years, for example, 15 years.
- The aim of the vision statement is to provide an answer to the question – ‘*What an organization wants to become?*’
- In other words, a vision statement defines the ‘strategic path’ of an organization.
- It provides a structured path to an organization by enabling it to focus on a predetermined future position and reduces the chances of deviations.

The vision statement of an organization should be achievable and measurable. It should be ambitious but not over-ambitious. It should be such that it is attained within the limits of available resources. It should be proposed keeping in mind the current environment as well as possible changes in the future environment. The vision of an organization is represented in the form of a vision statement. A vision statement must incorporate the thoughts of all stakeholders to ensure an

effective statement. The vision statement should possess the following traits in order to be effective:

- **Directional** – It should provide the managers and employees with a clear direction as to where the organization will be heading in future so as to facilitate strategy formulation in the same direction.
- **Feasible** – It should be such that it is achievable with relevance to the probable future environment,
- **Flexible** – It should be able to change in response to the changes in external as well as the internal environment of the organization, say technological changes or change in customer preferences.
- **Unique** – A vision statement differs for different organization as it is based on an organization's core value which is unique to an organization. Hence, it should be distinctive for every organization.
- **Inspiring** – It must be able to inspire and motivate the entire workforce of an organization.
- **Core Values** – It should depict the core values of an organization. It must reflect the purpose for which the organization exists.
- **Clear** – It should bring clarity to the minds of managers as how to make decisions and allocate resources for achieving success.

Purpose of vision statement

An effective and clear vision statement provides an organization with a clear strategic direction for future and sustainable advantage in the industry. An effective vision statement, therefore, serves various benefits for an organization in the ways as shown in figure 2.3.



Figure 2.3: Purpose of a vision statement

Envisioning is the process of creating vision. It is a difficult and is a complex task. A well-conceived vision must have:

- Core Ideology
- Envisioned Future

Core Ideology will remain unchanged. It has the enduring character. It consists of core values and core purpose. Core values are essential tenets of an organization. Core purpose is related to the reasoning of the existence of an organization.

Envisioned Future will basically deal with following:

- The long term objectives of the organization.
- Clear description of articulated future.

Advantages of Vision

A few benefits accruing to an organization having a vision are as follows:

- Fosters experimentation;
- Promotes long term thinking;
- Fosters risk taking;
- Can be used for the benefit of people;
- Makes organizations competitive, original and unique;
- Represents integrity;
- They are inspiring and motivating to people working in an organization.

CORE VALUES AND CORE PURPOSES

These concepts are very important in the process of envisioning. Collins and Porras have developed this concept for better philosophical perspective. As has already been discussed, a well-conceived vision consists of core ideology and envisioned future. Core ideology rests on core values and core purpose.

Core Values are the essential and enduring beliefs of an organization. They may be beliefs of top management regarding employee's welfare, customer's interest and shareholder's wealth. The beliefs may have economic orientation or social orientation. Evidences clearly indicate that the core values of A are different from the core values of B or C. The entire organization structure revolves around the philosophy coming out of core values.

Core Purpose is the reason for existence of the organization. Its reasoning needs are to be spelt clearly. The characteristics of core purpose are as follows:

- It is the overall reason for the existence of organization.
- It is 'why' of an organization.
- This mainly addresses to the issue which organization desires to achieve internally.
- It is the broad philosophical long term rationale.
- It is the linkage of organization with its own people.

1. What is core purpose? How is it different from core value?

.....

.....

.....

.....

2. Give examples of two companies with respect to core purpose and core values.

.....

.....

.....

.....

MISSION

Thompson states mission as the “essential purpose of the organization, concerning particularly why it is in existence, the nature of the business it is in, and the customers it seeks to serve and satisfy.

The above definition reveals the following:

- It is the essential purpose of organization.
- It answers “why the organization is in existence”.
- It is the basis of awareness of a sense of purpose.
- It fits its capabilities and the opportunities which government offers.

The mission of an organization incorporates the activities undertaken by an organization. It highlights the market target by the organization, technologies adopted and product and services offered. A mission segregates the organization from the other organizations in an industry. The aim of the mission statement is to answer the question – ‘What an organization does?’ In other words, it discusses the extent and spread of an organization’s operations.

The mission of an organization should be based on its core values. The core value of an organization is nothing but the fundamental beliefs, philosophy and principles of the organization. These core values and beliefs are the roots of any organization which does not undermine any financial or short-term benefits.

Nature

The nature of mission statement is as follows:

- It gives social reasoning. It specifies the role which the organization plays in society.
- It is philosophical and visionary and relates to top management values and has a long term perspective.

- It legitimizes societal existence.
- It has stylistic objectives and reflects corporate philosophy, identity, character and image of organization.

A mission is based on the aims of the organization and indicates the current position of an organization in the industry. It sets out the preferences for decision making at the strategic level. A mission is represented in a form of the mission statement. A mission statement puts forward the nature of the business, product or service range, ways of doing business, technological processes and the competitive strength of an organization. The mission statement of an organization is the starting point for the formulation of strategies. A mission statement is succeeded by setting up of objectives and goals. In other words, it should include all the aspects of the business in the present environment as shown in figure 2.4 explaining what an organization does.

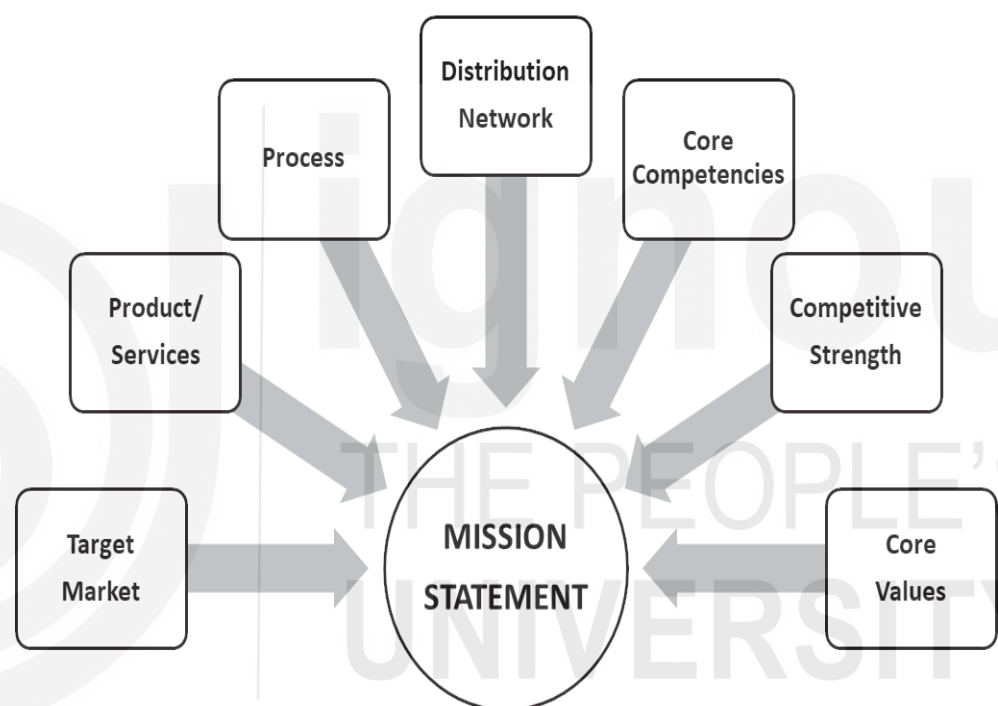


Figure 2.4: Elements of a Mission statement

In order to be effective a mission statement should possess the following features:

- **Achievable** – It should be constructed in a manner that it can be fulfilled with the available resources and organizational strengths and should be realistic in nature.
- **Easy to Understand** – It should not be complex. A mission statement is meant for employees and hence the language should be appropriately framed. It should be brief and positive.
- **Clear and Specific** – It should be precise and not vague. It should clearly indicate the business activities so that employees can remain focused.
- **Aspire** – It should be able to inspire the employees to adapt to the basic values and belief of the organization.
- **Individuality** – It should be able to define the character of an organization.

Mission statements are the qualitative statements which are needed to be converted into more practical terms. Therefore, they are followed by objectives and goals. Objectives and goals are a measurable form of targets which an organization wants to achieve. They break the qualitative mission statements into targets or aims which can be measured. Therefore, objectives and goals are statements which enable the management to measure the outcomes and progress. They are generally in quantitative terms but can be qualitative as well. Goals are the achievable outcomes which are made for long-term and specify what is to be achieved in broad sense. The objectives are the short-term actions which includes specified tasks required to fulfill long-term goals. The quantified objectives are more preferable as these provide better precision. They are easily understood by the workforce as they can clearly understand as to what is expected of them.

Objectives and goals should be drawn in line with the mission statement. They should express the mission statement of an organization. The objectives contain the period of time and acceptable level of risk involved in accomplishing the mission and vision of the organization. They should be made in such a manner that they are able to fulfill the mission and vision. A good objective is the one which covers the performance, profitability, environment, strength and weakness. The various traits which make objectives effective are shown in figure 2.5.

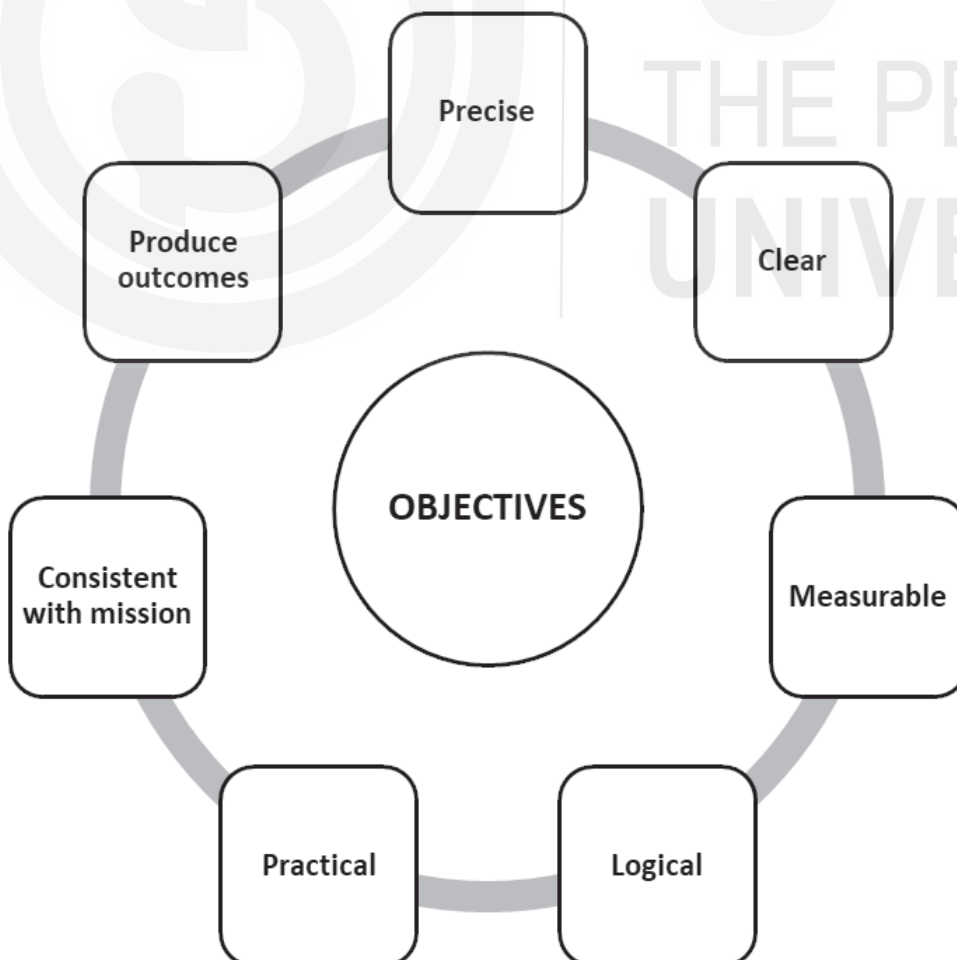


Figure 2.5: Traits of an effective objective

Difference between objectives and goals

Objectives and goals have certain differences. Table 2.1 shows these differences.

Table 2.1: Difference between Objectives and Goals

Parameters	Objectives	Goals
Degree	Specific	Broad
Time frame	Short term	Long term
Impact	Internal environment	External environment
Measurement	Quantitative	Qualitative

Broadly, it is more convenient to use one term rather than both. The difference between the two is simply a matter of degree and it may vary widely.

Need for Establishing Objectives

The following points specifically emphasize the need for establishing objectives:

- Objectives provide yardstick to measure performance of a department or SBU or organization.
- Objectives serve as a motivating force. All people work to achieve the objectives.
- Objectives help the organization to pursue its vision and mission. Long term perspective is translated in short-term goals.
- Objectives define the relationship of organization with internal and external environment.
- Objectives provide a basis for decision-making. All decisions taken at all levels of management are oriented towards accomplishment of objectives.

What Objectives should be set?

According to Peter Drucker, objectives should be set in the area of market standing, innovation productivity, physical and financial resources, profitability, manager performance and development, worker performance and attitude and public responsibility. Researchers have identified the following areas for setting objectives:

Profit objective is the most important objective for any business enterprise. In order to earn a profit, an enterprise has to set multiple objectives in key result areas such as market share, new product development, quality of service etc. Ackoff calls them performance objectives.

Marketing objective may be expressed as: “to increase market share to 20 percent within five years” or “to increase total sales by 10 percent annually”. They are related to a functional area.

Productivity objective may be expressed in terms of ratio of input to output. This objective may also be stated in terms of cost per unit of production.

Product objective may be expressed in terms of product development, product diversification, branding etc.

Social objective may be described in terms of social orientation. It may be tree plantation or provision of drinking water or development of parks or setting up of community centers.

Financial objective relates to cash flow, debt equity ratio, working capital, new issues, stock exchange operations, collection periods, debt instruments etc. For example an organization may state to decrease the collection period to 30 days by the end of this year.

Human resource objective may be described in terms of absenteeism, turnover, number of grievances, strikes and lockouts etc. An example may be “to reduce absenteeism to less than 10 percent by the end of six months”.

Characteristics of Objectives

The following are the characteristics of corporate objectives:

- i) They form a **hierarchy**. It begins with broad statement of vision and mission and ends with key specific goals. These objectives are made achievable at the lower level.
- ii) It is impossible to identify even one major objective that could cover all possible relationships and needs. Hence, **multiplicity of objectives** forces the strategists to balance diverse interests.
- iii) A **specific time horizon** must be laid for effective objectives. This timeframe helps the strategists to fix targets.
- iv) Objectives must be within reach and is also challenging for the employees. **Attainable objectives** act as a motivator in the organization.
- v) Objectives should be **understandable**. Clarity and simple language should be the hallmarks. Vague and ambiguous objectives may lead to wrong course of action.
- vi) Objectives must be **concrete** therefore they need to be quantified. Measurable objectives help the strategists to monitor the performance in a better way.
- vii) There are many constraints internal as well as external which have to be considered in objective setting. As different objectives compete for scarce resources, objectives should be **set within constraints**.

Process of Setting Objectives

Glueck identifies four factors that should be considered for setting the objectives. These factors are:

- The forces in the environment, realities of an enterprise’s resources and internal power relations;
- The value system of top executives and awareness by the management of the past objectives which are:
 - i) **Environmental forces**, both internal and external environmental forces, may influence the interests of various stake holders. Further,

these forces are dynamic in nature, hence objective setting must consider their influence on its process.

- ii) As objectives should be realistic, the efforts be made to set the objectives in such a way so that objectives may become attainable. For that, **existing resources of enterprise and internal power structure** be examined carefully.
- iii) The **values of the top management** influence the choice of objectives. A philanthropic attitude may lead to setting of socially oriented objectives while economic orientation of top management may force them to go for profitability objective.
- iv) Past is important for strategic reasons. Organizations cannot deviate much from the past. Unnecessary deviations will bring problems relating to resistance to change. Management must **understand the past** so that it may integrate its objectives in an effective way.

Activity 3

Select any organization of your choice. Formulate the vision, mission, objectives, and core purpose and core values for the organization.

.....

.....

.....

.....

2.4 STRATEGIC ANALYSIS

Strategic analysis involves the analysis of the internal and external environment of the organization. It is conducted to ascertain the circumstance under which the organization is operating for the purpose of strategy formulation. The major components of strategic analysis are:

- Conducting the environmental analysis;
- Assessing the existing strategies to check whether they fulfill the goals;
- Evaluate various strategic alternatives;
- Adopting the most viable strategy.

Environmental analysis involves assessing all the forces and factors which surrounds the organization. They are divided into internal and external environment analysis. The internal environment of an organization comprises of the factors which only affects that particular organization whereas external environment comprises of all the factors which affect the whole industry and all the organizations of that industry. There are various techniques used for analyzing the environment. A SWOT analysis is the most preferred technique for assessing the internal environment of an organization with respect to the external environment. A SWOT analysis is used for evaluating the strengths and weakness

of an organization in accordance with the opportunities offered and threats posed by the external environment. It helps in integrating strengths and weaknesses with opportunities and threats for maximum utilization of already available resources. A PESTLE analysis is a technique used for analyzing the external environment. It helps in evaluating Political environment, Economic environment, Socio-cultural environment, Technological Environment, Legal environment and Ecological environment. This analysis of the external environment helps in assessing the opportunities and threats in the external environment. It helps in assessing the conditions prevailing in the industry and hence enables an organization to take necessary actions as a response to those conditions. The other techniques of analysis which can be adopted by the organization are Porter's five force model for industry analysis and Value chain analysis for achieving core competencies.

2.5 STRATEGY FORMULATION

Formulation of strategies involves developing strategies at various levels of business and organization. Strategies are required to be formulated at the global level, corporate level and even at a functional level. Strategy formulation is preceded by strategic directions which are shown by an organization's vision, mission and objectives. Moreover, manager formulates strategies in response to external as well as the internal environment. The different stages involved in strategy formulation are depicted in figure 2.6.

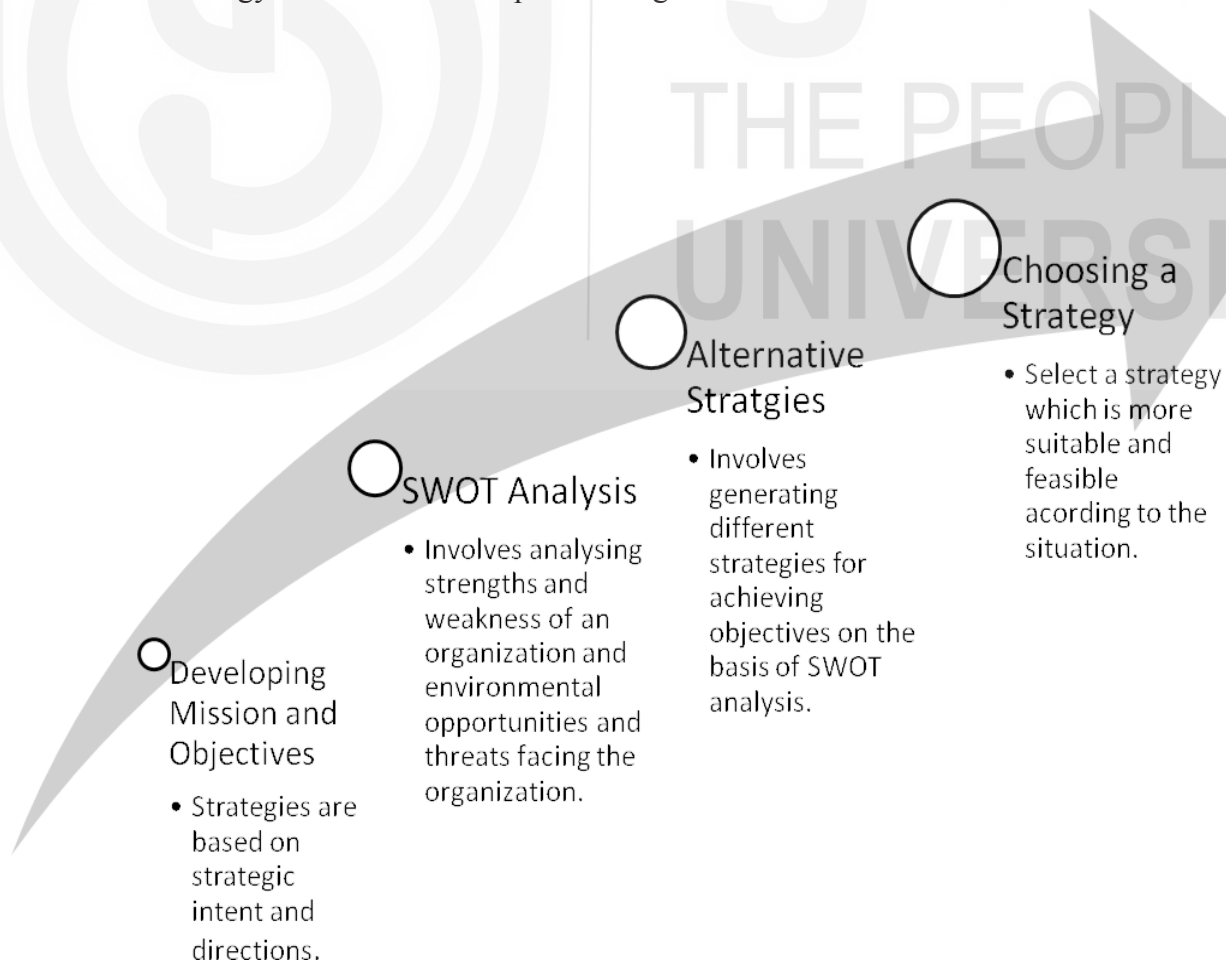


Figure 2.6: Stages of Strategy Formulation

Strategies are formulated at different levels based on the level of operations and management. These levels are – Corporate level, Business level and Functional level. The different levels of the strategy involve different strategic alternatives for different objectives of the organization. They are discussed as follows:

1. Corporate level strategies

Corporate level strategies are the strategies which are formulated by top management. These strategies primarily deal with decoding the mission of an organization into plans. These strategies are meant for a longer durations and are usually less specific than other levels of strategy. These strategies provide the organization with directions regarding the future of the organization as a whole. They are related to decisions regarding the size of the organization, the range of products or services, customer segments and the profitability of the organization. The corporate level strategies are also known as the ‘Grand Strategies’. These include stability strategy, growth strategy, retrenchment strategy and combination of all strategies. These are discussed in detail in block 2.

2. Business level Strategies

Organizations operating on a large scale or having geographically distributed operations divide their operations into several divisions or unit. These units are called strategic business units (SBUs). Each of these unit acts as separate businesses under one single parent organization. Generally, the business units operate in different industries and may have different brand names. Strategies adopted by such strategic business units are called business level strategies. These strategies enable the business units to acquire a competitive advantage over other organizations in the industry. In other words, business level strategies help in achieving industry competitive advantage. They help an organization in attaining the desirable market position and maintaining it.

The business level strategies are referred to as ‘Competitive strategies’. This is so because these strategies give a competitive edge to the organization in the industry and are used by the organization to be market leaders. The different types of business level strategies are cost leadership strategy, differentiation strategy and focus strategy. These are discussed in detail in block 2.

3. Functional level strategies

Functional level strategies are strategies relating to the basic functions of management. These strategies involve taking decisions on routine aspects of the business such as finance, human resource, marketing, purchase and operations. They are developed at the functional level of the organization. These are formulated for a shorter period of time. The effective implementation of functional strategies creates a base for strong business and corporate level strategies. Functional level strategies help in attainment of functional expertise and thereby leading to the development of core competencies for the organization. In other words, these strategies provide plans to manage a certain function in a manner that it assists the entire business of the organization.

Therefore, formulation of strategies is a complex task which involves an analysis of the internal as well as the external environment and strategic choices. An organization has to decide upon the strategy which is most suitable in the given set of circumstances.

2.6 CHOICE OF STRATEGY

The next logical step after evaluation of strategic alternatives is choice of the most suitable alternative. For a business group, it may be possible to choose all strategic alternatives but for a single organization it is quite difficult. The strategic alternatives have to be matched with the problem. While making a choice, two types of factors have to be considered. These are:

- Objective factors
- Subjective factors

Objective factors are the ones which can be quantified while subjective factors are the ones which cannot be quantified and are based on experience and opinion of people. Strategic choice is like a decision making process. There are three objective ways to make a choice:

- Corporate Portfolio Analysis
- Competitor Analysis
- Industry Analysis

Corporate Portfolio Analysis

When the organization is in more than one business, it can select more than one strategic alternative depending upon demand of the situation prevailing in the different portfolios. It is necessary to analyze the position of different business of the business house which is done by corporate portfolio analysis. This analysis can be done by using any of the seven technologies given below:

- Experience curve
- PLC concept
- BCG Matrix
- GE nine cell Matrix
- Space Diagram
- Hofer's product market evaluation matrix
- Directional Policy Matrix

Depending upon the stage of the **product life cycle** of the business, one can make a strategic choice for different portfolio.

Competitor Analysis

In this analysis, we try to assess what the competitor has and what s/he does not have. We explore everything with respect to the competitor. In competitor analysis, focus is on external environment as one of the components of external environment

is the competitor. The difference between SWOT analysis and competitor analysis is that in competitor analysis we are concerned with only one component of the environment i.e. competitor while in SWOT analysis we take about all the factors of the environment.

Industry Analysis

In industry analysis, all the competitors belonging to the particular industry with which the organization is associated are looked at. All the members of the industry are considered as a whole. In competitive analysis, only the major competitors are assessed while in industry analysis all the competitors belonging to the industry are looked at.

The strategic choice is a decision making process which looks into the following steps:

- Focusing on strategic alternatives
- Evaluating strategic alternatives
- Considering decision factors – objective factors and subjective factors.
- Finally, making the strategic choice.

2.7 STRATEGIC IMPLEMENTATION

Strategic implementation is the stage where the formulated strategies are executed. This is the phase of activating the strategies. Implementation of strategies involves exercising control over strategies while they are being implemented. Strategic implementation is the process of converting strategies into practices. This stage involves the following phases:

- i. Setting goals
- ii. Develop plans
- iii. Structuring the organization
- iv. Allocating resources
- v. Communicating the plans and goals
- vi. Motivating the employees
- vii. Establishing leadership

The process of strategic implementation consists of three main elements as shown in figure 2.7.

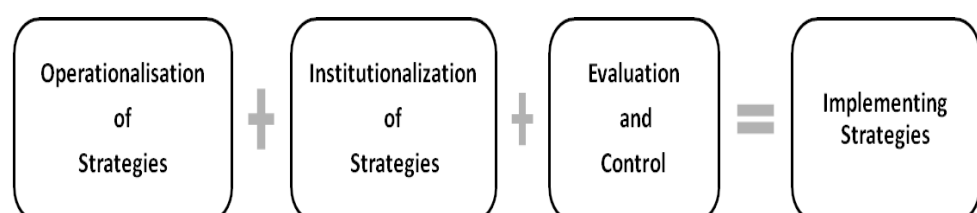


Figure 2.7: Elements in Strategic Implementation

Operationalizing of strategy is concerned with setting up of targets and plans, objectives, allocation of resources and communication of strategies. Establishing the organization structure and leadership leads to the institutionalization of strategies. Success is not only ensured by formulating a good strategy but it also requires effectively implementing the formulated strategies. The key factor to effectively implement a strategy is proper allocation of resources. The institutionalization of strategies requires a complete blend of strategies into the organization. This requires collective efforts at all levels of management and by all the employees of the organization.

2.8 STRATEGIC EVALUATION AND CONTROL

This is the final phase of the strategic management process. This step ensures that the implemented strategies meet their objectives, if not then perform corrective actions. Strategy Evaluation and Control is an ongoing process. It entails a feedback mechanism which provides for continuous monitoring of the process of strategies implemented.

In the era of globalization and rapidly changing environment, the traditional method of control is insufficient. The traditional method of evaluation and controlling involves establishing standards, measurement of actual performance and drawing comparison between the actual performance and standard performance to find deviations. Corrective actions are taken if deviations are found. The modern day approach pushes for a continuous and ongoing evaluation of strategic planning and implementation. The continuous evaluation is required in case of a long period of time, along with the traditional method. It involves exercising and control by the way of monitoring the strategies as they are being executed, finding problems and undertaking corrective measures.

There are two types of organizational controls which are known as strategic control and operational control as shown in figure 2.8.

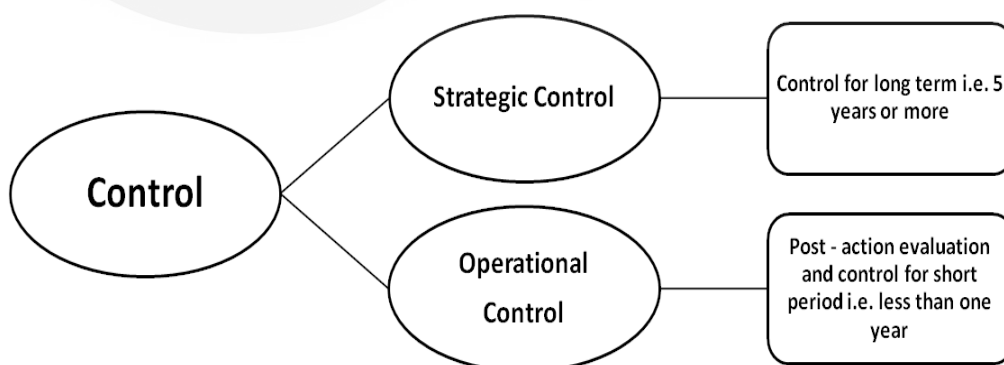


Figure 2.8: Types of Control in an organization

Strategic Control includes the following types of control:

- Premise Control
- Implementation Control
- Special Alert Control
- Strategic Surveillance

Operational Control includes the following categories:

- Budgeting
- Budgeting techniques are of various types which are as follows:
 - Zero-based budgeting
 - Programme budgeting
 - Performance budgeting
- Scheduling
- Management Control System
- Feedback control system
- Division performance measurement

In all the process of strategic management is the most crucial part for any strategy to be effective.

2.9 SUMMARY

Strategic management is the process involving the manner in which a particular strategy is developed. The process of strategic management involves establishing strategic intent. Strategic intent sets out the future path for the organization along with the objectives which an organization wants to achieve. Strategic intent refers to the purpose for which the organization strives for. It is the philosophical framework of strategic management process. The hierarchy of strategic intent covers the vision and mission, business definition and the goals and objectives. Vision constitutes future aspirations. This articulates the position that a organization would like to attain in the distant future. Mission is the social reasoning of organization. It has external orientation. It legitimizes social existence. Objectives are the ends that state specifically how the goals should be achieved. Overall this unit tries to give a view of strategic intent as a whole.

Formulation of a strategy depends upon the desirable future path and analysis of the surrounding environment. Strategies are formulated after assessing the factors prevailing in the internal as well as the external environment of the organization by deploying techniques such as SWOT analysis and PESTLE analysis. Strategies are formulated to achieve the organizational objectives and goals. These objectives and goals can be achieved not just by formulating the strategies but by properly implementing them. The strategic implementation consists of operationalizing and institutionalizing strategies and allocation of resources. Strategic implementation needs to be followed by continuous evaluation and control in order to ensure that the strategies are deployed as planned.

2.10 KEYWORDS

Core Purpose : It is the reason for organization's existence.

Core Values : It is the essential and enduring character of organization.

Goals	:	A broad category of financial and non-financial issues that a organization sets for itself.
Mission	:	It is the social reasoning of an organization and links organization to society.
Objectives	:	These are the manifestation of goals.
Strategic Intent	:	It makes clear what an organization stands for.
Vision	:	It indicates what an organization wishes to achieve in the long run.

2.11 SELF-ASSESSMENT QUESTIONS

- 1) What is strategic intent?
- 2) What is mission? How is it different from purpose? Discuss the essentials of a mission statement.
- 3) Stage five mission statements of big companies in India and review them critically.
- 4) What are objectives? How are they set? State the characteristics of objectives.
- 5) How will you set objectives for a large organization? Take a hypothetical example.
- 6) Explain the following:
 - Core Value
 - Core Purpose
 - Leverage
- 7) Surf two companies of your choice on internet and collect the details regarding hierarchy of strategic intent.
- 8) Strategy formulation, implementation, evaluation and control are integrated processes. Give arguments.
- 9) Strategic analysis is an essential prerequisite for formulating the strategies. Give reasons for it.

2.12 REFERENCES AND FURTHER READINGS

Henry, A. E. (2018). What is strategy? In *Understanding Strategic Management* (3rd ed., pp. 3-34). Oxford, United Kingdom: Oxford University Press.

Kishor, R. M. (2016). Strategic planning. In *Strategic Management* (2015 ed., pp. 106-137). Delhi: Taxmann publication.

Kishor, R. M. (2016). Strategy formulation. In *Strategic Management* (2015 ed., pp. 138-177). Delhi: Taxmann publication.

Kishor, R. M. (2016). Overview of strategic management. In *Strategic Management* (2015 ed., pp. 3-29). Delhi: Taxmann publication.

Kishor, R. M. (2016). Strategy implementation and control. In *Strategic Management* (2015 ed., pp. 213-238). Delhi: Taxmann publication.

Morden, T. (2016). The concepts of mission, objective, and strategy. In *Principles of strategic management* (3rd ed., pp. 175-200). New York: Routledge.

Nag, A. (2011). Understanding strategic management project. In *Strategic Management* (1st ed., pp. 3-41). New delhi, Delhi: Vikas publishing house.

Nag, A. (2011). Organization mission, competences and the environment. In *Strategic Management* (1st ed., pp. 65-111). New Delhi: Vikas publishing house pvt.

Strategic Management - Developing Vision Statements. (2018, May 07). Retrieved December 27, 2018, from <http://higherstudy.org/strategic-managements-developing-vision-statements>



ignou
THE PEOPLE'S
UNIVERSITY

UNIT 3 STRATEGY IN GLOBAL CONTEXT

Objectives

After reading this unit, you should be able to:

- Understand the meaning of global business environment;
- Understand the process of environmental analysis;
- Acquaint yourself with the PESTLE analysis in international business;
- Assess the different alternatives of strategy in global context.

Structure

- 3.1 Introduction
- 3.2 Need for Internationalization
- 3.3 Global Business Environment
- 3.4 Environmental analysis in global context
- 3.5 Environmental Analysis process
- 3.6 PESTLE analysis
- 3.7 Global strategic alternatives
- 3.8 Entry to global markets
- 3.9 EPRG Framework
- 3.10 Global Supply Chains and Competitiveness
- 3.11 Summary
- 3.12 Keywords
- 3.13 Self-Assessment Questions
- 3.14 References and Further Readings

3.1 INTRODUCTION

Organizations throughout the world do not function in a void. They are surrounded by different forces which collectively create an environment for the businesses and such business environment is highly dynamic in nature. This is due to the reason that the different forces or factors which comprise the business environment are determined by various variables which are not constant and change rapidly based on circumstances. In case of global business, this environment expands to a global level whereby local business environments of various nations adjoin.

Thus, it is necessary for any business, domestic or global, to understand the environment in which it is operating. This requires an in-depth analysis of business

environment. Analysis of business environment involves identifying, scanning and monitoring of the environmental factors. Once the analysis is conducted, the next is determining the strategic alternatives based on the result of environmental analysis. This unit provides a deep learning of business environment and its factors followed by the strategic alternatives available to an organization from the point of view of global business.

3.2 NEED FOR INTERNATIONALIZATION

An organization can “go international” by crossing domestic borders as it employs any of the strategies. International expansion involves establishing significant market interests and operations outside an organization’s home nation. Foreign markets provide additional sales opportunities for a organization that may be constrained by the relatively small size of its domestic market and also reduces the organization’s dependence on a single national market. Organizations expand globally to seek opportunity to earn a return on large investments such as plant and capital equipment or research and development, or enhance market share and achieve scale economies, and also to enjoy advantages of locations. Other motives for international expansion includes extending the product life cycle, securing key resources and using low-cost labour. However, to mold their organizations into truly global organization, managers must develop global mind-sets. Traditional means of operating with little cultural diversity and without global competition are no longer effective.

International expansion is fraught with various risks such as, political risks (e.g. instability of host nations) and economic risks (e.g. fluctuations in the value of the nation’s currency). International expansions increases coordination and distribution costs and managing a global enterprise entails problems of overcoming trade barriers, logistics costs, cultural diversity, etc.

3.3 GLOBAL BUSINESS ENVIRONMENT

Environment of any entity, whether living or non-living, is comprised of its surroundings. It includes all the resources and forces around that particular entity. Environment provides the entity with the resources required for its survival and growth. In case of business organizations, the surrounding environment is called as business environment. It comprises of all the internal as well as external factors affecting an organization. These internal and external factors also have an impact on each other. Internal factor of the business environment includes all the forces which can be managed and controlled by the organization. Internal factors are the resources and capital available with the organization. External factors include the forces over which the organization has no control. External factors are responsible for threats and opportunities an organization may encounter whereas internal factors are responsible for strengths and weaknesses of the organization. Environment consists of all the factors which might have an impact on the organization’s capabilities

With the businesses going global, the business environment has expanded to the global level. Global business involves operations of business activities in more than one nation. The organizations operating in two or more nations are referred

to as multi-national or trans-national organizations. Such organizations have to manage their activities in multiple nations and hence have to deal with national environments of the different nations. Global environment covers all the forces which not only relies in the local and national territory of the organization but also includes all the factors which the organization may have to encounter within the foreign land. It includes interaction between the forces of local, national and international environment.

Internal Environment

Internal environment includes the resources, assets and liabilities of an organization. It includes the strengths and weaknesses of the organization. Technological know-how, machinery, patents, human resource and distinguished products and services are considered as the strengths of an organization. On the contrary, legal charges, debts, liabilities and obsolete technology are some of the weaknesses of an organization. It focuses on achieving success by strengthening the core capabilities of the organization. Internal environment helps in structuring the process of strategy formulation whereas external environment is the base for formulation of organizational strategies. Internal environment sets the boundaries for the formulation of strategy in response to external environment. Success of an organization is dependent upon the resources it possesses. It is important for an organization to have necessary resources to obtain maximum benefits from an opportunity. An organization can gain competitive advantage in international markets on the basis of its unique resources and capabilities.

External environment

Forces outside an organization can change the future course of action and decide the success and failure of the organization. External environment of an organization includes all those forces which cannot be controlled or influenced by a single organization. It includes the threats which an organization may have to face and opportunities which an organization may get while functioning in that environment. These are the factors which are faced by the entire industry. External environment includes factors of industry environment and macro-environment. Industry level factors are related to the buyers, suppliers, shareholders and other intermediaries whereas macro environment includes political, technological, economic, social and cultural factors.

In case of international external environment, these factors expand to a global scale where the organization is impacted by the macro environment factors of other nations. For example, an increase in the living standards of the customers in India led to an increase in demand of mobile phones which paved way for various international mobile phone manufacturing organizations to enter the Indian markets. It is important for any organization to access its external environment, measure its impact, adapt to the changes and consistently monitor the situation to sustain in international markets.

3.4 ENVIRONMENTAL ANALYSIS IN GLOBAL CONTEXT

Global environmental analysis involves scanning the different environments of different nations before preparing a strategy. International business has a necessity

to assess the requirement of international markets in order to gain the competitive advantage. Environmental scanning includes scanning the internal as well as external environment. Internal environment can be analyzed by scanning the strengths, weaknesses, threats and opportunities. Once the managers have learnt about the organizational strengths and weaknesses they should scan the external or macro environment for analyzing, developing and implementing the strategic alternatives. For example, the managers should analyze the technological assets of the organization and then analyze the needs of the customers along with the current trends of the industry and activities adopted by the competitors. Global environmental scanning should include critical analysis of global trends and market segmentation for organizations to develop strategies for effectively penetrating the already established international markets or create a new global market for them. There are several ways for scanning the environment. Various methods for analyzing the internal and external environment are BCG consulting, SWOT analysis, Value chain analysis, Porter's five force model, Mckinsey's 7s model and PESTLE analysis.

3.5 ENVIRONMENTAL ANALYSIS PROCESS

The process of analyzing the business environment includes several steps as shown in figure 3.1. These are:

- **Factor Identification:** The first step in the process of analyzing the environment is identifying the factors prevailing in the environment. The environmental factors differ from nation to nation.
- **Factor Selection:** The next step involves selecting the relevant factors and analyzing the related variables to forecast the effect of such factors on the business.
- **Variable analysis:** This is followed by profiling the factors according to the positive and negative aspects it can create for the business.
- **Strategic Positioning:** The last step in the process of environmental analysis is determining a strategic position based after analyzing the environmental threats and opportunities and organizational strengths and weakness.

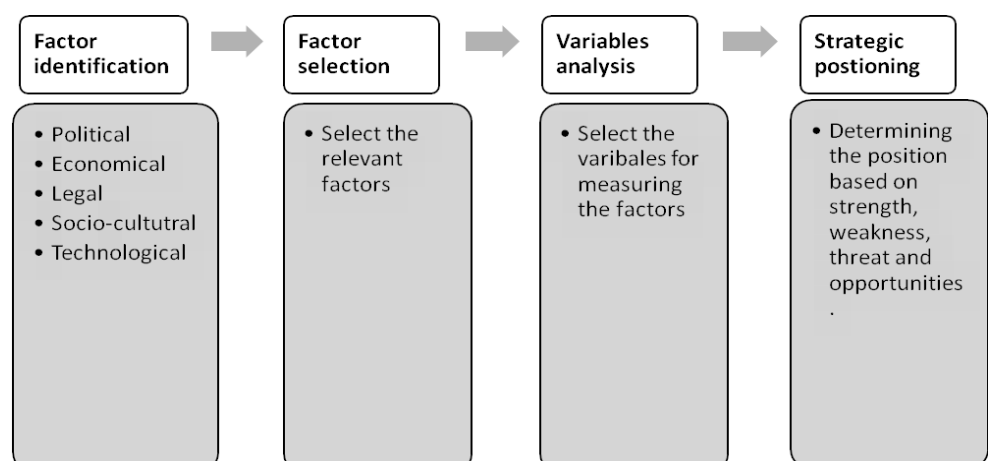


Figure 3.1: Process of Environmental Analysis

Environmental analysis at the global level involves environmental scanning across various international markets which is a continuous task as global business environment can be highly dynamic.

Activity 1

1. Explain the need for scanning the environment.

.....

.....

.....

.....

2. Is global environmental analysis more complex than the analysis of domestic environment? Justify?

.....

.....

.....

.....

3.6 PESTLE ANALYSIS

PESTLE analysis is an important tool used for analyzing the external environment, especially in foreign markets. PESTLE stands for political, economic, social, technological, legal and environmental factors which exist in an international business environment. It helps in gaining insights on the external threats and opportunities faced by an organization. It helps an organization in getting insights on organizational vision. PESTLE analysis helps in planning strategic alternatives based on the desired strategic position which an organization wants to attain. A business organization has to function in dynamic environment and therefore, the need to analyze different factors arises which is important to sustain in the market.

PESTLE analysis becomes more essential in case of international business as a manager needs to analyze the different factors prevailing in different nations at a given point of time. For example, the manager needs to plan strategies based on the domestic labour laws, economic conditions and government policies before entering the market of that nation. There are three steps involved in conducting a PESTLE analysis. These are:

- The first step involves considering the factors which are relevant to the organization.
- Next step is concerned with identifying the information which can give a clear picture about the relevant factors.
- The final step involves analyzing the data and drawing conclusions from the selected information. For example, if a manager wants to analyze economic factors, then s/he needs to assess the information related to GDP, and tax policies to develop an effective strategy for entering those

markets. The various factors covered under PESTLE analysis are depicted in figure 3.2.

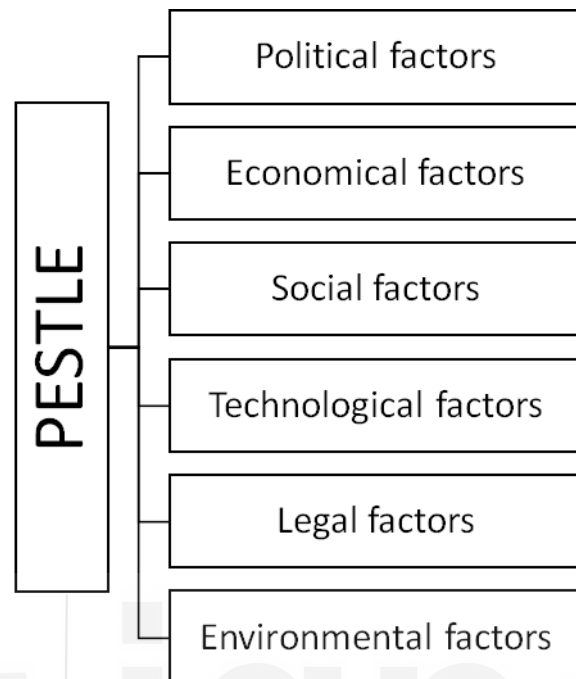


Figure 3.2: Factors analyzed under PESTLE analysis

The different factors under PESTLE analysis are discussed below with respect to the global business environment.

Political factors

Political factors are related to the government regulations, policies and laws with regards to the trade, commerce, economy, human resources and environment of a nation. It includes all the laws the government of a nation passes. It also includes the trade treaties which a nation enters into with the nations across globes such as trade treaties between ASEAN nations. Political factors also include the rules setup by the legislation which binds the working environment in a nation such as working hours and working conditions. In case of international business, the rules and regulations made between two nations or a group of nations play an important role. For instance, FDI policies adopted by a nation will determine the future investments by international organization into that nation.

A few examples for international political factors can be-

- Stability of the political environment
- Foreign trade policies
- Local taxation rules
- Membership of international summits and groups such as ASEAN, BRICS or G20

Economic Factors

Economic factors can affect the way an organization does its business in a market. These factors are responsible for the demand and supply of a commodity in a nation. Economic factors include rate of inflation, interest rate, foreign exchange

rate and economic growth pattern. The economic factors of a nation can predict the profitability of a business if the organization enters into that foreign nation. These factors can easily influence the way an organization can function in a foreign nation. For instance, high rate of inflation in any economy can influence the money supply into the economy and adversely affect the purchasing power of customers. This can lead to a decline in demand for consumer goods which can result into losses for business.

A few examples for international economic factors can be-

- Current and future predictions regarding GDP of the nation
- Foreign exchange rates in the international market and their impact on cost of production
- Current and forecast of inflation rates

Social Factors

Social factors are related to the social behaviour and cultural effects prevalent among the people of a nation. It includes local languages, religious beliefs and cultural practices. It also includes the manner in which the population of the nation responds to the laws, rules and regulations. The demand for the product and services of an organization can also be affected by the attitude of the customers towards them. Therefore, organizations should take into consideration the social values of a nation before launching their products into the foreign market. Social factors also include the demographic aspects of the nation. A global business needs to adapt itself to the social and cultural environment of the nation before entering the domestic market of any foreign nation.

A few examples of international social factors can be-

- Purchasing habits and the lifestyle of the customers in a foreign domestic market
- Demographic profiles of target customers
- Religious and cultural beliefs of the customers
- Attitude towards work policies

Technological factors

In the present complex and competitive world, technology is the most important asset for any organization for achieving competitive advantage in a market or industry. The new and advanced technologies enable an organization to develop better products and services for the target markets. It may allow an organization to innovate new products, processes or services which can ultimately lead to creation of new markets for the organization. Technological factors include patents, research and development, technological advancements and automation technology owned by an organization. For instance, the emergence of artificial intelligence in the form of smart devices into everyday life is a form of technological advancement which can give an organization edge over its competitors.

A few examples of technological factors can be-

- Intellectual property rights in the foreign nations
- Availability of resources for development of technology
- Level of technology absorption in the foreign nation
- The current status of technology in the foreign market

Legal Factors

Legal factors are related to the rules, regulation and laws of a nation. These factors can impact the micro and macro environment of an organization. For instance, the labour laws of a nation can influence the human resource policies of an organization in foreign nation. Moreover, an organization needs to obtain various permissions from the regulatory bodies and adhere to the legal requirements. Legal factors include environmental laws, industry regulations, consumer protection laws and other statutory requirements.

A few examples of legal factors can be-

- Laws related to consumer protection
- Laws related to nation's environment
- Laws related to human resources

Environmental factors

Environmental factors include all the factors related to physical environment of the nation and the rules related to the protection of the environment. Environmental factors include climate, weather conditions, environmental laws, geographical location and global environmental conventions. For instance, organization based in tourism sector or agricultural produce are highly influenced by environmental factors.

A few examples of environmental factors can be-

- Environmental protection laws
- Climate conditions of a nation
- Rules related to disposal of waste and energy consumption
- Policies formulated under international environmental conventions

The analysis of global business environment is not confined to PESTLE analysis. The organizations apply their internal assessment mechanisms as well to have the feel of the foreign environment before entering a specific market.

Activity 2

1. State some international policies deployed for improving physical environment across the world.

.....

.....

2. How will you identify whether the economic and political factors in a nation are favourable or not?

3.7 GLOBAL STRATEGIC ALTERNATIVES

After performing an environmental analysis, the manager needs to develop strategic alternatives for making a business global. There are several approaches which one can undertake for going global. The organization has to decide as to how they want to internationalize their business. The process of internationalizing a business is based on two decisions regarding the strategies to be adopted for making the process of business international and the extent to which the organization wants to invest in the international market.

There are three major strategy options for going international. These are:

Multi-domestic: The organization decentralizes operational decisions and activities to each nation in which it is operating and customizes its products and services to each market. For example, U.S. auto manufacturers maintained decentralized overseas units that produced cars adapted to different nations and regions.

Global: The organization offers standardized products and uses integrated operations. Example: An automobile company is treating its Contour as a car for all world markets—one that can be produced and sold in any industrialized nation.

Transnational: The organization seeks the best of both the multi-domestic and global strategies by globally integrating operations while tailoring products and services to the local market. In other words an organization ‘thinks globally but acts locally’. Many authors refer to this concept as ‘Globalization’. Global electronic communications and connectivity can help integrate operations while flexible manufacturing enables organizations to produce multiple versions of products from the same assembly line, tailoring them to different markets. This gives more choice in locating facilities to take advantage of cheaper labour or to get the best of other factors of production

3.8 ENTERING GLOBAL MARKETS

The first step for entering the global markets is to choose the mode of entering. There are several modes of entering into a foreign market. The modes differ on the basis of the level of investment into the market. An organization selects a mode for entering into foreign market depending upon the risk taking

capacity and the information available for the prospective market. For instance, an organization having access to required information regarding a prospective foreign market will be able to assume more risk and opt for higher level of investments into the market.

Some of the modes of entry include exporting, licensing, franchising, strategic alliance, acquisition and joint venture. Licensing is the least risk options where organization can offer their technology to other vendors in foreign. On the other hand, franchising involves more engagement in the foreign markets through sharing of technology and patents. It involves least monetary investment into a foreign market. Exporting is another low investment entry mode where organization can sell the products they produced for domestic markets into a foreign market. Though, it involves engagement with export agents in the foreign market but the cost involved is still low. These modes of entry have less investment and low risk on investment. On the contrary, joint venture and strategic alliance involve higher risk and investment. These modes involve investing huge sum of money into foreign markets where an organization ties up with a domestic organization of the host nation. An organization needs to select an entry mode depending upon the strategic position they want to assume.

There are several methods for going international. Each method of entering an overseas market has its own advantages and disadvantages that must be carefully assessed. Different international entry modes involve a tradeoff between level of risk and the amount of foreign control the organization's managers are willing to allow. It is common for a organization to begin with exporting, progress to licensing, then to franchising finally leading to direct investment. As the organization achieves success at each stage, it moves to the next. If it experiences problems at any of these stages, it may not progress further. If adverse conditions prevail or if operations do not yield the desired returns in a reasonable time period, the organization may withdraw from the foreign market.

The decision to enter a foreign market can have a significant impact on a organization. Expansion into foreign markets can be achieved through:

- Exporting
- Licensing
- Joint Venture
- Direct Investment

Exporting: Exporting involves marketing of domestically produced goods in a foreign nation and is considered to be a traditional and well-established method of entering foreign markets. It does not entail new investment since exporting does not require separate production facilities in the target nation. Most of the costs incurred for exporting products are marketing expenses.

Licensing: Licensing gives permit to an organization in the target nation to use the property of the licensor. Such property usually is intangible, such as trademarks, patents, and production techniques. The licensee pays a fee in exchange for the rights to use the intangible property and possible for technical assistance. Licensing has the potential to provide a very large ROI since this mode of foreign entry also requires additional investments. However, since the

licensee produces and markets the product, potential returns from manufacturing and marketing activities may be lost.

Joint Venture: There are five common objectives in a joint venture: market entry, risk/reward sharing, technology sharing, joint product development, and conforming to government regulations. Other benefits include political connections and distribution channel access that may depend on relationships.

Joint ventures are favoured when:

- The partners' strategic goals converge while their competitive goals diverge;
- The partners' size, market power, and resources are small compared to the industry leaders; and
- Partners' are able to learn from one another while limiting access to their own proprietary skills.

The critical issues to consider in a joint venture are ownership, control, length of agreement, pricing, technology transfer, local organization capabilities and resources, and government intentions. Potential problems include, conflict over asymmetric investments, mistrust over proprietary knowledge, performance ambiguity – how to share the profits and losses, lack of parent organization support, cultural conflicts, and finally, when and how to terminate the relationship.

Joint ventures have conflicting pressures to cooperate and compete:

- Strategic imperative; the partners want to maximize the advantage gained for the joint venture, but they also want to maximize their own competitive position.
- The joint venture attempts to develop shared resources, but each organization wants to develop and protect its own proprietary resources.
- The joint venture is controlled through negotiations and coordination processes, while each organization would like to have hierarchical control.

Direct Investment: Direct investment is the ownership of facilities in the target nation. It involves the transfer of resources including capital, technology, and personnel. Direct investment may be made through the acquisition of an existing entity or the establishment of a new enterprise. Direct ownership provides a high degree of control in the operations and the ability to better know the customers and competitive environment. However, it requires a high degree of commitment and substantial resources. Table 3.1 compares different International Market Entry Modes.

Table 3.1: Comparison of International Market Entry Modes

<i>Mode</i>	<i>Conditions Favouring this Mode</i>	<i>Advantages</i>	<i>Disadvantages</i>
Exporting	• Limited sales potential in target nation; little product adaptation required	• Minimizes risk and investment • Speed of entry	• Trade barriers & tariffs add to costs

	• High target nation; production costs • Liberal import policies • High political risk	• Maximizes scale; uses existing facilities	• Transport costs • Limits access to local market information • Organization viewed as an outsider
Licensing	• Import and investment barriers • Legal protection possible in target environment • Low sales potential in target nation • Large cultural distance • Licensee lacks ability to become a competitor	• Minimizes risk and investment • Speed of entry • Able to circumvent trade barriers • High ROI	• Lack of control over use of assets • Licensee may become competitor • Knowledge leakages • License period is limited
Joint Ventures	• Import barriers • Large cultural distance • Assets cannot be fairly priced • High sales potential • Some political risk • Government restrictions on foreign ownership • Local organization can provide skills, resources, distribution network, brand name etc.	• Overcomes ownership restrictions and cultural distance • Combines resources of the organization • Potential for learning • Viewed as insider • Less investment required	• Difficult to manage • Dilution of control • Greater risk than exporting & licensing • Knowledge spillovers • Partner may become a competitor
Direct Investment	• Import barriers • Small cultural distance • Assets cannot be fairly priced • High sales potential • Low political risk	• Greater knowledge of local market • Can better apply specialized skills • Minimize knowledge spillover • Can be viewed as an insider	• Higher risk than other modes • Requires more resources and commitment • May be difficult to manage the local resources.

3.9 EPRG FRAMEWORK

EPRG framework is concerned with four strategic orientations which an organization can adopt for managing its international business. EPRG stands for Ethnocentric, Polycentric, Regiocentric and Geocentric orientation.

These orientations are based on the strategies which an organization can adopt when going global. These orientations differ from each other on the basis of the variations in business operations in regional or global arena.

Ethnocentric approach

Under this approach, the entire process of managing the global business is based in the domestic nation of the organization. The organization assumes foreign markets as secondary markets. The entire process of strategic decision-making and control is vested in the domestic or local nation where headquarter of the organization is situated. The organization believes that the products manufactured in the domestic nation are suitable for selling in the foreign markets. In other words, the products or services offered in the local markets are to be sold in the global markets without any alterations made to suit the customers of global markets. The whole process of producing the products is based in the domestic nation and the finished goods are exported to the foreign nations for sale. Further, under ethnocentric approach an organization adopts single marketing strategy which implies that same marketing strategy is followed in the international markets which has been deployed in the local markets. The organization following this approach ignores the needs and demands of the global customers. Therefore under ethnocentric approach, the organization develops strategies as per the domestic nation's preferences and applies those strategies throughout the world without making any changes in them.

Polycentric approach

Under this approach, the process of managing the global business is based in the different foreign markets where an organization wants to sell their products or services. This approach is opposite to ethnocentric approach. In this approach, the strategic control is given to the subsidiaries situated in the foreign nations. These subsidiaries are allowed to develop strategies based on the needs and demands of the customers residing in that foreign nation. The production process is also situated in the foreign nation. In other words, the products and services are highly localized to serve the foreign customers. Hence, the products, services and the marketing strategies vary from nation to nation. For example, an organization selling its product in two international markets, say India and Japan will have different range of products for the customers of both the nations based on their needs. Therefore under polycentric approach, organizations develop different strategies in different nations depending upon the preferences of the customers residing in those nations.

Regiocentric approach

Regiocentric approach is based on the division of global markets into particular regions, such as South-Asian region, European region or American region. In other words, the entire world is clubbed into different regions based on certain similarities. Under this approach, an organization formulates different strategies for different regions. This implies that the different nations pertaining to one region will follow same strategy. The markets located in different nations of a region are assumed as one single international market based on common traits. The same range of products and services are offered to the customers of a particular regions. These products and services are developed based on the needs and demands of all the customers belonging to a particular region. Hence the products

and services are less localized in comparison to the ones under polycentric approach. The marketing strategies are also common for all foreign markets coming under one region. For example, an organization will plan different international strategies for European markets and South-Asian markets. However, a single strategy will be implemented in different European nations such as Germany, Spain and Italy whereas another single strategy will be implemented in South-Asian nations such as Vietnam, Thailand and Malaysia.

Geocentric Approach

Under this approach, the entire world is depicted as one single market. This implies that there is no difference between domestic nation and foreign nations. An organization following geocentric approach formulates strategy based on the global needs of the consumer. The same products and services offered in all the markets throughout the globe. The production process can be situated anywhere in the world depending upon low-cost of production and availability of raw material. This approach enables effective adaptation to the changing needs across the different nations. Such an approach is suitable for an organization which makes high-end products with unique features such as luxury car-makers.

3.10 GLOBAL SUPPLY CHAINS AND COMPETITIVENESS

Logistics capabilities (the movement of supplies and goods) make or mar global operations. Global operations involve highly coordinated international flow of goods, information, cash, and work processes. Setting up a global supply chain to support producing and selling products in many nations at the right cost and service levels is a very difficult task. However the benefits of managing this difficult task has many benefits, which includes rationalization of global operations by setting up right number of factories and distribution centers and integration of far-flung operations under a unified command to better manage inventory and order filling activities. Optimizing global supply chain operations can cut the delivery times and costs drastically and improve global competitiveness. Smart supply chain planning may result in locating facilities where they make the most logistical sense, while saving on taxes. This is better than simply locating where labor is cheapest, but where taxes and other cost may not be most favourable.

3.11 SUMMARY

Business environment consists of different factors at different levels. There are two environments which surrounds an organization. The first one is internal or micro environment which depicts the strength and weakness of an organization. The second environment is the external or the macro environment which depicts the threats and opportunities to an organization. There are different techniques of analyzing business environment such as SWOT analysis, PESTLE, Porter's five force model, value chain analysis, Mckinsey's model and many more. However, PESTLE analysis is widely used for scanning the global business environment as it covers various factors which can affect a business organization. PESTLE scans political, economic,

technological, social, legal and environmental factors. Based on the environmental analysis, a manager needs to decide which strategic alternatives the organization should opt for sustaining in international markets. The organization must decide on the level of investment which they can make into a foreign nation based on their risk-taking capacity. There are several modes of entering into a foreign market such as exporting, franchising, and licensing and many more. Apart from deciding upon the mode of entering into the foreign markets, the organization has to decide an approach for formulation and implementation of business strategies in case of international business. There are four approaches named as ethnocentric, poly centric, regiocentric and geocentric approach. Each approach has different scope of planning and implementing global business strategies. In all the strategic perspective to the global market is at a larger level.

3.12 KEYWORDS

Internationalization	:	It is the process under which an organization plans to expand their operations in the international markets
EPRG Framework	:	It provides a framework for adoption of different strategies while going global.
Exporting	:	It involves sale of domestically produced goods in a foreign nation without any modification in them.
Licensing	:	It involves adopting the technical knowledge, tangible and intangible assets for a licensing fee.

3.13 SELF-ASSESSMENT QUESTIONS

1. Distinguish between global environment and domestic environment.
2. Differentiate between external environment and internal environment.
3. Explain external environment analysis with some recent examples.
4. Describe the EPRG framework with respect to global business.

3.14 REFERENCES AND FURTHER READINGS

Frynas, J. G., & Mellahi, K. (2013). Global business environment: the external environment. In *Global Strategic Management* (2nd ed., pp. 40-44). Oxford University Press.

Frynas, J. G., & Mellahi, K. (2013). Global Business Environment: the internal environment. In *Global Strategic Management* (2nd ed., pp. 115-121). Oxford University Press.

International Business: PESTLE analysis. (2020, September 18). Retrieved October 06, 2020, from <https://libguides.library.usyd.edu.au/c.php?g=508109>

Nag, A. (2011). General strategic choices. In *Strategic Management* (1st ed., pp. 66-69). New Delhi, Delhi: Vikas publishing house.

Nag, A. (2011). MNE and Strategic Environment. In *Strategic Management* (1st ed., pp. 50-57). New Delhi, Delhi: Vikas publishing house.

PESTLE, Globalization, and Importing. (n.d.). Retrieved October 06, 2020, from https://saylordotorg.github.io/text_international-business/s12-02-PESTLE-globalization-and-import.html

Scanning and Monitoring Global Marketing Environment. (2019, December 10). Retrieved October 06, 2020, from <https://theintactone.com/2019/07/06/im-u1-topic-7-scanning-and-monitoring-global-marketing-environment/>

SHRM. (2019, August 16). What are the basics of environmental scanning as part of the strategic planning process? Retrieved October 05, 2020, from <https://www.shrm.org/resourcesandtools/tools-and-samples/hr-qa/pages/basics-of-environmental-scanning.aspx>



ignou
THE PEOPLE'S
UNIVERSITY



BLOCK 2

ENVIRONMENTAL ANALYSIS

**THE PEOPLE'S
UNIVERSITY**

BLOCK 2 ENVIRONMENTAL ANALYSIS

This block aims at understanding the concept of environmental analysis. It is necessary for any organization to identify the potential markets so that the goals of the organization are achieved. Therefore, it becomes necessary for the organization to assess its environment especially its current and potential resources. This block discusses the external as well as internal environmental which is important part of strategic analysis.

Unit 4: External Environmental Analysis helps understand the environmental (external) factors in detail and the PESTLE analysis framework in analyzing their impacts on strategic development.

Unit 5: Competitive Analysis focuses on the next immediate layer of the external environment called as the competitive environment. This refers to the situation, which an organization faces within its specific area of operations. The Porter's Five Forces model is the universally popular model to analyze the competitive environment. The five forces model which focuses on forces beyond direct rivalry is discussed here to broaden your understanding of how such forces shape up strategies and affect performance in a competitive environment. Further within, most industries or sectors we find many organizations with different characteristics and the basis for their business or competition is found to be different. Analyzing the forces in such cases is possible by using the concept of strategic groups discussed in this unit. This will also help understand the layers, which may exist between the industry and the individual organization.

Unit 6: Internal Environmental Analysis as the name suggests it explains the internal analysis of an organization where focus is on analyzing and understanding organizations' resources and competencies, which help managers match capabilities with opportunities or neutralize threats effectively. Also this helps managers to explain potential uniqueness of the organizations contributing to their superior performance.

UNIT 4 EXTERNAL ENVIRONMENT

Objectives

After reading this unit, you should be able to:

- Understand the importance of environmental analysis;
- Acquaint yourself with the broad dimensions in a general environment;
- Know the relationship between the general environment and strategy;
- Understand the concept of Industrial Organization (I/O) model;
- Know the PESTLE framework for analysis and the implications of its factors.

Structure

- 4.1 Introduction
- 4.2 General Environment and Strategy
- 4.3 Process for analyzing the External Environment
- 4.4 External Environment
- 4.5 Industrial Organization Model
- 4.6 PESTLE Framework
- 4.7 External Factor Evaluation Matrix
- 4.8 Summary
- 4.9 Keywords
- 4.10 Self-Assessment Questions
- 4.11 References and Further Readings

4.1 INTRODUCTION

Strategic analysis is basically concerned with structuring the relationship between a business and its environment. The environment in which a business operates has a greater influence on their successes or failures. There is a strong linkage between the changing environment, the strategic response of the business to such changes and the performance. It is therefore important to understand the forces of external environment the way they influence the linkage. The external environment which is dynamic and changing holds both opportunities and threats for the organizations. The organizations while attempting at strategic realignments, try to capture these opportunities and avoid the emerging threats. At the same time the changes in the environment affect the attractiveness or risk levels of various investments of the organizations or the investors.

The first level of the external analysis i.e. understanding of the macro environment has an influence on the success or failure of an organization's strategies. The impact of the changes of the macro environment is felt on the organization and its strategies through their influences on the competitive forces of the competitive

environment. Assessing the external environment is also known as environmental scanning or industry analysis. In this unit we will learn a practical approach to assessing and analyzing the external information and understand the concept of Industrial Organization (I/O) model.

4.2 GENERAL ENVIRONMENT AND STRATEGY

A manager needs to analyze the kind of impact the change may bring in their own industry as the impact are never same for all industries. For example, the emerging younger demographic profile of India will have very different consequences for businesses say in health care or entertainment. While the former will face an adverse effect, the latter will have a positive effect and these needs to be analyzed and integrated into strategic decision making. In response to these assessments of differential impacts, managers will be able to take advantages of the opportunities or guard themselves of the threats. Exhibit 1 shows how in different ways various industries get affected by the different environmental trends.

Responding to these various impacts with new strategic initiatives the managers must take notice of the fact that if the changes are significant, it may have the potential of changing the competitive rules of the game in the industry. For example, in India the competitive rules of the game for sectors like telecom, banking and insurance etc, in the post liberalization period changed specially in last few years. With the pandemic crisis, the rules have changed all the more as more stress is towards digitization. With the easing of FDI and participation of major global players, norms have changed dramatically which is reflected in the strategies of most of the organizations in the sector. These changes can be seen in the area of technology and pricing, intensity of advertising and promotions, their business alliances and network in the nation.

Managers need to be cautious of the fact that there may be developments, which are not so easy to predict and therefore need further attention so that they can be incorporated in their strategy. In the global context, the managers must see the kind of impact any single change will have in different markets. It is quite possible that they are very different both in degree and their nature.

Exhibit 1: Environmental trends and their probable impact on different sectors

Environmental trends	Probable positive effects	Probable neutral effects	Probable negative effects
1. Aging population	Medical services	Minerals	Colleges and schools
2. Multiple income families	Fast food	Machine tools	Grocer's supplies
3. Deregulation	Shipping		Financial sector
4. Increased environmental legislation	Waste management	Software	Leather
5. Growing global	Telecommunication/ small scale/ handicrafts	Competition	

The PESTLE analysis gives a number of factors and their likely influences. However it is important to identify the specific factors which may influence an industry and force them towards competitive adjustments. These factors are termed as structural drivers of change which have the likely effect on the structure of an industry or on the competitive environment.

As a first step based on PESTLE analysis, the key driving forces need to be identified and then impact of the combined effect of these forces should also be made. Increasing globalization of the industry and the E enabled era could make such driving forces capable of affecting the structure of an industry or its environment.

4.3 PROCESS FOR ANALYZING THE EXTERNAL ENVIRONMENT

Let us now see the process for analyzing the external environment. This consists of three steps which are as follows:

Step 1: Environmental scanning

Step 2: Assimilation

Step 3: Evaluation

The process of analyzing the external environment requires three steps to be followed. In the first step the organization should gather all the information related to political, economic, socio-cultural, technological, legal and environmental (PESTLE) trends. This can be done using internet, magazines, newspapers etc. A periodic scanning report of these factors can be submitted for performing the external audit. The second step involves assimilation of all the information gathered. This involves assessing the opportunities and threats available with the organization. The last step in this process is evaluating. In this the key external factors need to be identified and a list of the same is to be made. These key factors should be important in helping long term objectives of the organization and should be measurable in nature. Using these sources the environmental analysis for any organization can be done.

Environmental scanning

The factors or the forces understood under PESTLE framework put together, present a highly complex and uncertain environment which are difficult to predict or foresee. From a long term view of strategy however, reaching somewhat closer to such forces are important in understanding the key factors influencing the success of such strategies.

Environmental scanning is one of the few ways to detect future driving forces early and this involves studying and interpreting the developments of social, political, economic, ecological and technical events that could become driving forces. It attempts to figure out few radical happenings or path breaking developments which may be catching on and see their possible implications 5 to 20 years into the future. The purpose of environmental scanning is to raise the

consciousness of managers about potential developments that could have an impact on industry conditions resulting in new threats or opportunities. Environmental scanning is normally accomplished by systematically monitoring and studying current events, constructing scenarios and employing the Delphi method (a technique for finding consensus among a group of knowledgeable experts).

Constructing scenarios involves a detailed plausible view of how the business environment of an organization might develop in the future based on the groupings of key environmental influences and drivers of change about which there is high level of uncertainty. For example in industries like energy, transportation, defence equipment etc. there is a need for views of the business environment of more than 10-15 years and factors like raw materials, substitutes, consumption patterns, geo politics etc. would be of crucial importance. Foreseeing precisely for such a longer duration may be very difficult but drawing up possible futures may be viable. It is not unnatural to believe that several scenarios could unfold overtime and these need to be understood. Scenario planning technique is briefly discussed in Unit 5 under the competitive environment.

4.4 EXTERNAL ENVIRONMENT

The macro environment in which all organizations operate broadly consist of the economic environment, the political and legal environment, the socio cultural aspects and the environment related issues like pollution, sustainability etc. The technological temper and its progress has been the key driver behind the major changes witnessed in the external environment making it increasingly complex.

These factors often overlap and the developments in one area may influence developments in other. For example, the opening up of economy integrated the markets globally and increased the competition between private and public organizations. This forced the Indian government to revisit its economic policies. Under its new liberalization policy and economic reforms of 1991, regulations like MRTP, which restricted the size of the business and therefore inhibited their efficiency and competitive levels, were removed with a positive impact on the indigenous industries. The current political developments are sure to have an impact on the minds of business people regarding the future policy direction in certain sectors. The social considerations in the context of a developing nation like India also play a critical role in deciding the broad dynamics of the business environment. The clash of ideologies between preserving the Indian ethos and culture and giving a freedom of choice to people often create problems and confusion for business.

4.5 INDUSTRIAL ORGANIZATON MODEL

Let us now discuss the Industrial Organization (IO) Model which forms the basis to understand the concept of strategy leading to competitive advantage. The Industrial Organization Model adopts an external perspective on strategic decision- making. It begins with the idea that external factors have major effects on organization's strategic activities. In other words, this model assumes that the features and conditions of the external environment

impact the formulation and implementation of strategies in order to generate above-average returns and thereby gain competitive advantage. Under this model, external environment forces the organization to develop strategies to meet that demand at the same time limiting the spectrum of tactics that may be suitable and ultimately effective. Further, the model assumes that all organizations operating within an industry possess similar set of resources. This implies that, due to the similarity among set of resources, majority of organizations operating in a certain industry or a section of an industry has comparable skills and consequently pursues similar tactics. The resources required to put strategy into action are highly transferable among organizations. Significant distinctions in strategically relevant resources across enterprises in an industry tend to diminish due to high resource mobility.

The industrial organization model follows a process for achieving competitive advantage as shown in figure 4.1. The steps involved are discussed as below:

- Examine the external environment which includes general, industrial, and competitive environment to identify the external environment attributes and both decide and limit the organization's strategic solutions.
- Based on the structural parameters of the industry, industry (or industries) is to be chosen with a high potential for returns.
- Strategies associated with above-average returns should be developed based on the features of the industry in which the organization plans to operate.
- Acquire or develop the key resources required for successful implementation of the formulated strategies and plans.
- The model indicates that competitive advantage will be achieved if an organization successfully implements the strategic actions which enable an organization to utilize its resources for meeting the demands of external environment.

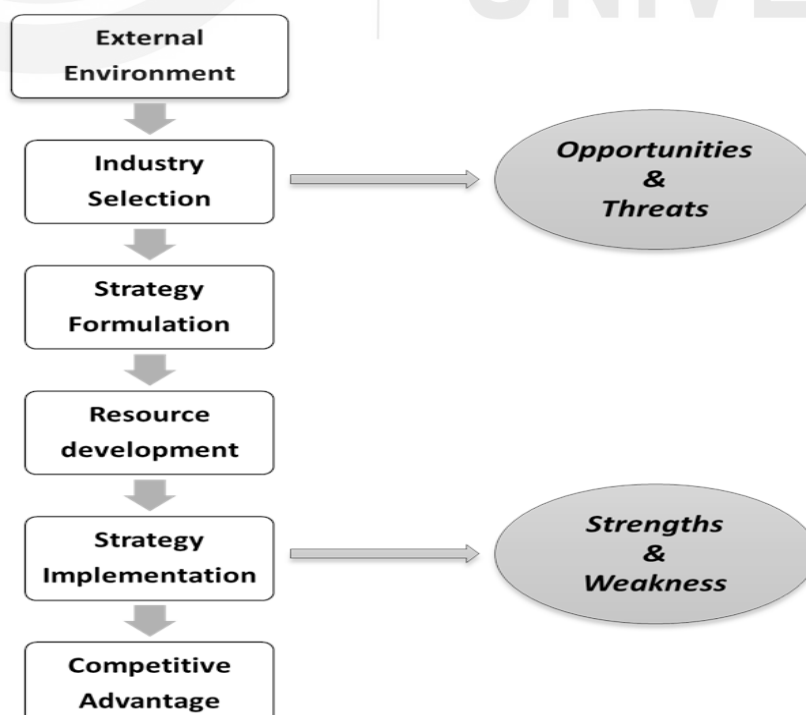


Figure 4.1: Industrial Organization Model

This model is important for the organizations as it helps them assess the strategic position of the organization.

4.6 PESTLE FRAMEWORK

The external forces can be classified into six broad categories: Political, Economic, Social, Technological, Environmental and Legal Forces. Changes in these external forces affect the changes in consumer demand for both industrial and consumer products and services. These external forces affect the types of products produced, the nature of positioning, market segmentation strategies, the types of services offered, and choice of business. Therefore, it becomes important for the organizations to identify and evaluate external opportunities and threats so as to develop a clear mission, design strategies to achieve long-term objectives and develop policies to achieve short term goals. Here, we will discuss all the six forces individually and then try to come to the conclusion regarding environmental analysis. A careful analysis of the above factors will help in identifying major trends for different industries. Exhibit-2 shows the PESTLE framework which is most popularly used for such analysis.

Few indicative points are listed to guide you to find the key factors in the general environment. While PESTLE framework may be used to understand the most important factors at the present time, it should be primarily used to look into the future impact which may be different from their present or past impact.

Exhibit 2: PESTLE Framework

The PESTLE Framework- Macro-environmental influences. The framework primarily involves the following two areas:

1. The environmental factors affecting the organization;
2. The important factors relevant in the present context and in the years to come.

Political

1. Government stability
2. Political values and beliefs shaping policies
3. Regulations towards trade and global business
4. Taxation policies
5. Priorities in social sector

Economic Factors

1. GNP trends
2. Interest rates/ savings rate
3. Money supply inflation rate
4. Inflation rate
5. Unemployment

6. Disposable income
7. Business cycles
8. Trade deficit/surplus

Socio-cultural Factors

1. Population demographics
 - Ethnic composition
 - Aging of population
 - Regional changes in population growth and decline
2. Social mobility
3. Lifestyle changes
4. Attitudes to work and leisure
5. Education-spread or erosion of educational standards
6. Health and fitness awareness
7. Multiple income families

Technological

1. Biotechnology
2. Process innovation
3. Digital revolution
4. Government spending on research
5. Government and industry focus on technological effort
6. New discoveries/development
7. Speed of technology transfer
8. Rates of obsolescence

Legal

1. Monopolies legislation/Antitrust regulation
2. Employment law
3. Health and safety
4. Product safety

Environmental

1. Carbon emissions
2. Pollution levels
3. Environmental sustainability
4. Global warming
5. Biodegradable material

Political factors

Politics has a serious impact on the economic environment of a nation. Political ideology and political stability or instability strongly influence the pace and direction of the economic growth. It also contributes to the economic environment which is conducive for some businesses to grow or indifferent for some businesses or at times be a hurdle. The governments at any levels be it central, state, local and foreign, all have an impact on the businesses. These are the major regulators or deregulators. The businesses all over depend largely on the contracts of government, subsidies etc. which form a major part of external environment. Any change in the laws, regulations, tax slabs etc. can affect the organization to a large extent.

Looking back into the history due to certain ideological beliefs prevalent in some section of politics, few of foreign organizations had to move out of India in the late 70s. Entry barriers, protectionist policies, high tariffs, nationalist pursuits all worked towards a closed economy which continued till the time liberalization policies were introduced in 1991. This situation had a cumulative effect on making the economy weak and the businesses were hardly competitive as compared to the international standards. However in subsequent years, the political consensus developed on issues such as labour reforms, power sector reforms, importance of infrastructure etc. and these sectors are doing a lot good for business.

Activity 1

Identify few key active political forces. Discuss how they are shaping the overall environment in the nation.

.....

.....

.....

.....

.....

.....

Economic factors

Exhibit 3 gives you a view of broad indicators which give the economic picture of the general environment and these should be carefully looked into while doing the environmental analysis.

Exhibit 3: Common Economic Indicators

A. National Income GNP Personal disposable Income Personal consumption	B. Policy Initiatives Monetary policy Fiscal policy Labour and employment policy
C. Savings Personal savings Corporate savings Balance of Payments	D. Foreign Sector Exchange rates Exports/Imports

E. Industry Industry Investment FDI flows Services Infrastructure	F. Sectoral Growth Agriculture Industry
G. Capital Market Equity market Bond market	H. Prices, Wages, Productivity Inflation Labour productivity

Economic factors throw light on the nature and direction of the economy in which an organization operates. The organizations must focus on economic trends in segments that affect their industry. For example the trend of low interest rates on personal savings may compel individuals to move towards equity and bond markets leading to a boom in the capital market activity and the mutual fund industry. Consumption patterns are usually governed by the relative affluence of market segments and organizations must understand them through the level of disposable income and the tendency of people to spend. Interest rates, inflation rates, unemployment rates and trends in the gross national product, government policies and sectoral growth rates are other economic influences it must consider.

The services sector's contribution to national income is increasing year after year and the family incomes are rising faster than individual incomes, job opportunities are more diverse and therefore these speak for different types of opportunities and challenges which are emerging before the business. With the opening up of the economy, trends in the global market needs a careful look. The above needs to be analyzed and incorporated in your inferences for the general environment and its other forces and how all these together may influence business.

Activity 2

Suppose the foreign exchange reserves in the nation gets depleted by half of the present level because of few developments in the outside world. Discuss the environmental effects it may lead to.

.....

.....

.....

.....

.....

Social factors

Socio-cultural factors have a major impact on the markets, products, services and customers. Almost all the organizations face challenges arising from the changes in demographic and cultural variables. Let us discuss these in brief.

Demographic Factors: Demographic characteristics such as population, age distribution, literacy levels, inter-state migration, rural-urban mobility, income distribution etc. are the key indicators for understanding the demographic impact

on environment. The shifts in age distribution caused by improved birth control methods have created opportunities for youth centric products ranging from clothes to entertainment to media. The growing number of senior citizens and their livelihood needs have been highlighted and the government is paying more attention in the form of social security benefits etc.

Considering literacy and the composition of literates in the nation creates opportunities for particular type of industries and type of jobs. For example on one hand, the presence of a large number of English speaking engineers encouraged many software giants to set up shops in India and on the other, the availability of cheap labour, India becomes a destination for labour intensive projects. Moreover, large labour mobility across different occupations and regions, in recent times, has cut down wage differentials greatly and this has an impact for businesses which needs to be understood.

Cultural Factors: Social attitudes, values, customs, beliefs, rituals and practices also influence business practices in a major way. Festivals in India offer great business opportunity for certain industries like clothes and garments, jewellery, gift items, sweetmeats and many others, the list could be endless.

Social values and beliefs are important as they affect our buying behaviour. For example, a multinational fast food chain does not serve the beef burgers in India because Indians do not have cow meat since the animal is considered holy and sacred. A related example of an entertainment giant also brings out clearly, the impact different cultures may bring to business. This organization which has been so successful in the US market could not be so successful in European nations because of the difference in the way in which people entertain themselves there. Due to this they had to customize its offerings in order to be successful in these markets. The spread of consumerism, the rise of the middle class with high disposable income, the flashy lifestyles of people working in software, telecom, media and multinational companies seem to have changed the socio-cultural scenario and these needs to be understood deeply. The pandemic crisis bringing the Work from Home (WFH) culture also has impacted the way the market is perceived. Values in society also determine the work culture, approach towards stakeholders and the various responsibilities the organization thinks of owing to its stockholders and the society.

Activity 3

There has been a thrust on women literacy. Discuss the influences you see in the social environment and their impact on business.

.....

.....

.....

.....

Technological factors

Technological factors represent major opportunities and threats which must be taken into account while formulating strategies. Technological breakthroughs can drastically influence the organization's products, services markets, suppliers,

distributors, competitors, customers, manufacturing processes, marketing practices and competitive position. Technological advancements can open up new markets, change the relative position of industry and render existing products and services obsolete. Technological changes can reduce or eliminate cost barriers between businesses, create shorter production runs, create shortages in technical skills and result in changing values and expectations of customers and employees.

The impact of information technology (IT) which combines fruits of both telecommunications and computers has been revolutionary in every field. Not only has it opened up new vistas of business but also has changed the way the businesses are done. IT has specifically brought in another dimension 'Speed' which organizations recognize as the additional source of competitive advantage beyond low cost and differentiation. Manufacturers, bankers and retailers have used IT to carry out their traditional tasks at lower costs and deliver higher value added products and services. The pandemic situation has altogether changed the way the organizations work. Artificial intelligence, robotics, cloud computing, blockchain technology etc. have penetrated the business world to a large extent.

Activity 4

Enumerate few of the technological advances in the field of agriculture and discuss its role in tapping better opportunities in the overseas markets.

Legal factors

Licensing policies, quota restrictions, import duties, FOREX regulations, FDI regulations, controls on distribution and pricing of commodities together made business difficult before the liberalization. However, with economic reforms things have changed and legal formalities have eased. Nevertheless with globalization, the rules of competition, trade mark rights and patents, WTO rules and implications, price controls and product quality laws and a number of other legal issues in individual nations have become important and therefore they need to be included while understanding the general environment.

Activity 5

Discuss the legislation on patents in India and its impact on the business.

Environmental factors

Environment conservation and protection is an issue, which has gained prominence because of deteriorating environmental balance which is threatening the sustainability of life and nature. Largely, businesses are also held responsible for such situations as emissions from industries polluting the air, excessive chemical effluents drained out in water making it poisonous and unfit for use, usage of bio non-degradable resources affecting the bio-chain adversely and exposure of employees to hazardous radiations bring their life in danger. All these have been taken very seriously by different stakeholders in the society including the government and legislations and movements are creating pressure for an environment friendly business. These have far reaching implications for businesses ranging from the kind of business, the product being manufactured, how it is manufactured and how friendly it is for mankind and nature. Many multinationals that come under the purview of the society regarding the environmental hazards have started using more sustainable methods to survive in the business. The businesses all over are now concentrating more on preserving the nature than harming it.

The competitive environment refers to the situation which organization's face within its specific area of operation, and this can be understood at an industry level or with respect to smaller groups called Strategic groups. Generally understood, an industry in the economy is recognized as a group of organizations producing the same principal product or more broadly the group of organizations producing products that are close substitutes for each other and in a given industry different organizations have different intermediate basis of understanding its relative position with respect to other organizations in the industry.

Organizations within an industry with similar strategic characteristics, following similar strategies or competing on similar bases are called strategic groups. These characteristics for a particular group will be different from those in other strategic groups in the same industry or sector. There may be many different characteristics, which distinguish between strategic groups. For example size, breadth of product range, geographical coverage, quality or service levels or marketing spend. The concept of strategic groups when used helps in understanding who is the direct competitor of any given organization and on what basis competitive rivalry is likely to take place within each strategic group. There are competitive forces beyond direct rivals which shape up the competitive environment that can be better understood with the five forces framework which we will discuss in unit 5.

Activity 6

List out five major industries which in your view, may pose danger to the environment. Suggest measures as to how these industries may act in an environment friendly nature.

.....

.....

4.7 EXTERNAL FACTOR EVALUATION MATRIX

The External Factor Evaluation Matrix (EFE) is a tool which helps strategists to summarize and evaluate the PESTEL factors. This involves five steps which are as follows:

1. List key external factors
2. Assign weight to each factor
3. Assign a rating to each factor
4. Determine a weighted score
5. Determine the total weighted score.

Let us see how each step is to be performed to find out the EFE. Exhibit 4 gives an example of EFE.

1. **List key external factors:** Once the PESTEL is performed, key external factors are identified. In this all the factors (10 or 20) are included which determine the opportunities and threats for the organization. Then the listing of all the opportunities and threats is done using percentages, ratios etc.
2. **Assign weight to each factor:** This is the second step where each factor is assigned weight ranging from 0.0 (not so important) to 1.0 (very important). These weights depict the relative importance to each factor. These weights are determined by comparing successful competitors with unsuccessful ones or through a group discussion in the organization. The sum of all weights should be 1.0. These are industry based.
3. **Assign rating to each factor:** A rating of 1 to 4 factors is assigned. This is done to show the effectiveness of the organization's present strategic response to the factor. The rating scale is depicted as below:
 - 1 = Poor response
 - 2 = Average response
 - 3 = Above average response
 - 4 = Superior response.

Ratings are organization based.
4. **Determine a weighted score:** This is the fourth step and it involves multiplying weight of each factor by its rating.
5. **Determine the total weight score:** This is the last step to be performed and in this step a score of the weighted score of each variable is considered and this gives the total weighted score of the organization.

Exhibit 4: External Factor Evaluation (EFE) Matrix of X Inc.

Key External Factors	Weight (0.0 – 1.0)	Rating (1 - 4)	Weighted score (Weight X Rating)
Opportunities			
1. Global markets untapped by alcohol free beverages	0.15	1	0.15
2. Increased demand by ban on use of alcoholic beverages	0.05	3	0.15
3. Growth of social media advertising	0.05	1	0.05
4. Social pressure to reduce use of alcoholic beverages	0.15	4	0.65
5. Y the leader in discounted alcoholic beverage market	0.10	3	0.30
Threats			
1. Limit against public use of alcohol	0.10	2	0.20
2. Limit on production of alcohol increases competition	0.05	3	0.15
3. Alcohol free beverage market concentration in another region of the nation	0.05	2	0.10
4. Poor media exposure	0.10	2	0.20
5. Government regulation	0.20	1	0.20
Total	1.00		2.10

One thing is to be noted here is that despite number of opportunities or threats in an EFE matrix the maximum possible weighted score for an organization is 4.0 and the minimum possible score is 1.0. This shows that if an organization gets a weighted score of 4.0, then the response of the organization to the opportunities and threats is excellent and vice-versa. The example shown in exhibit shows the total weighted score of 1.0. This indicates the organization is not able to tap the opportunities and avoid the threats. Therefore, it is important for organizations to have a thorough understanding of the factors so as to maximize the opportunities and minimize the threats.

4.8 SUMMARY

Understanding of the general environment in which an organization operates is the foremost prerequisite towards strategy formulation. The six broad dimensions which this PESTLE framework provides the environment-political, economic, socio- cultural, technological, legal and environmental are capable of giving a comprehensive overview of how things may be unfolding. The objective of the analysis of this framework however should not only restrict to the present and

past but the real focus should be on projecting the trends into future in order to get the real feel of the environment. This shall enable the organizations to proactively strategize for future considering the general environment. EFE matrix is used to assess these factors.

The immediate competitive environment influences an organization and therefore has to be understood alongside the general environment. It is therefore a challenging task for managers to imitate and formulate strategies which can effectively neutralize the negative impact on the competitive structure of industry generated by these forces.

4.9 KEYWORDS

PESTLE Framework	: This framework categorizes environmental influences into 6 main types — political, economic, social, technological, legal and environmental.
Structural Drivers of Change	: The factors which have a likely effect on the structure of an industry or on the competitive environment.
Environmental Scanning	: One of the few ways to detect future driving forces.
Competitive Environment	: It refers to the situation which an organization faces within its specific arena of operation.

4.10 SELF-ASSESSMENT QUESTIONS

- 1) Briefly summarize what you understand by the general environment and its importance for business.
- 2) Explain what is external analysis and its relationship with strategy formulation?
- 3) Briefly explain the PESTLE framework.
- 4) Identify an industry of your choice and do a PESTLE analysis.
- 5) Explain the Industrial Organization Model.

4.11 REFERENCES AND FURTHER READINGS

David, R. Fred. (2007). *Strategic Management: Concepts and Cases* Prentice Hall International Inc.

Haberberg, A. & Rieple, A. (2010). *Strategic Management* (2010ed.). New York: Oxford University Press.

Henry, A. E. (2018). *Understanding Strategic Management* (3rd ed.). Oxford, United Kingdom: Oxford University Press.

Johnson, Gerry & Scholes, Kevan. (2004). *Exploring Corporate Strategy*. Sixth edition, Prentice-Hall of India, New Delhi.

Kazmi, A. (2008). *Business Policy and Strategic Management* (3rd ed.). Delhi: Tata McGraw Hill Publishing Co, Ltd.

Kishor, R. M. (2016). *Strategic Management* (2015 ed.). Delhi: Taxmann publication.

Miller, Alex. *Strategic Management, Third edition*. Irwin McGraw Hill.

Peters, Thomas J. and Robert, H. Waterman, Jr. (1982). *In Search of Excellence lessons from America's Best- Run Companies*, New York: Harper and Row.

Prasad, L.M. (2002). *Business Policy: Strategic Management*. Delhi: Sultan Chand & Sons.

Shrivastava, R. M. (2017). *Management Policy and Strategic Management*(3rd ed.). Mumbai: Himalaya Publication House.

Thompson, A. Arthur, Jr. and Strickland, A.J. III. (2003). *Strategic Management, Concepts and Cases*, Thirteenth edition. Tata McGraw Hill Publishing, New Delhi.



ignou
THE PEOPLE'S
UNIVERSITY

UNIT 5 COMPETITIVE ANALYSIS

Objectives

After reading this unit, you should be able to:

- Learn about competitive forces;
- Understand the concept of competitive analysis;
- Understand Porters five forces framework;
- Know the role of strategic groups in competitive analysis;
- Analyze the social media competitive analysis;
- Understand the Competitive Profile Matrix (CPM).

Structure

- 5.1 Introduction
- 5.2 Competitive forces
- 5.3 Porter's five forces framework
- 5.4 Strategic Groups
- 5.5 Scenario Planning
- 5.6 Social media competitive analysis
- 5.7 Competitive Profile Matrix
- 5.8 Summary
- 5.9 Keywords
- 5.10 Self-Assessment Questions
- 5.11 References and Further readings

ignou
THE PEOPLE'S
UNIVERSITY

5.1 INTRODUCTION

In unit 4 we have learnt how the external environment is scanned. This unit is in continuation to the external analysis. In this unit we will discuss the importance of competitive analysis in the external environment scanning and will learn different aspects of competitive analysis. We have seen that it is very important to identify the competitors and determine their strengths, weaknesses, opportunities and threats. This is the reason a proper competitive analysis is required. The unit discusses how the analysis goes beyond the scope of a single business unit and how strategic groups become important. The unit focuses on Porter's five forces model which describes the competitive analysis in detail. The unit also explains the competitive profile matrix. Overall the unit gives a detailed description of competitive analysis through various modes.

5.2 COMPETITIVE FORCES

Any organization can only be successful if it has the ability to formulate an effective strategy. This can be done by collecting all the relevant information about competitors and evaluate them to formulate their own strategy. It has been witnessed in many cases that identifying the competitors is quite difficult as number of organizations have divisions which compete in different industries which means that the businesses are diversified. Most of the organizations do not make the sales and profit information public due to competitive reasons. In present times internet has become a major source for obtaining the information on the competitors.

Competition in any industry is usually intense. In the past many cases have been witnessed whereby the organizations have capitalized on the weaknesses of its competitors. Therefore it is very important to understand the forces which are important for a competitive analysis. These are:

- Strengths of the competitors;
- Weaknesses of the competitors ;
- Objectives and strategies of the competitors;
- Response of the competitors towards PESTLE factors;
- Vulnerability of the competitors to alternative strategies of other organization;
- Vulnerability of the organizations to their alternative strategies;
- Positioning of the products / services relative to major competitors;
- The status of entry and exit of new and old business organizations respectively;
- The key factors resulting in the present competitive position in the industry;
- Trends of the sales and profits ranking of major competitors in the industry;
- Supplier and distributor relationships in the industry;
- Threat to the competitors due to the substitute products/ services.

This is not an exhaustive list. However this gives an idea about the competitive forces which are important in conducting a competitive analysis.

5.3 PORTER'S FIVE FORCES FRAMEWORK

Competitive analysis is one of the most critical parts of an organization's strategic plan. This involves identifying the strategies of the competitors to assess their strengths and weaknesses and thereby evaluating them. A proper evaluation of a competitor's strategy helps the organization in establishing the USP (Unique Service Proposition) of its product or service. The evaluation of the competitors

can be done by placing them in strategic groups which we will discuss in section 5.4. Porter's Five-Forces Model of competitive analysis is one of the most widely used approaches to develop strategies as shown in figure 5.1.

The five forces framework developed by Michael Porter is the most widely known tool for analyzing the competitive environment, which helps in explaining how forces in the competitive environment shape strategies and affect performance. The framework as shown in figure 5.1 suggests that there are competitive forces other than direct rivals which shape up the competitive environment. These competitive forces are as follows:

- 1) The rivalry among competitors in the industry
- 2) The potential entrants
- 3) The substitute products
- 4) The bargaining power of suppliers
- 5) The bargaining power of buyers

However, these five forces are not independent of each other. Pressures from one direction can trigger off changes in another which is capable of shifting sources of competition. In the following section each of these five forces are discussed in detail so as to understand how each of these forces affect an Industry's environment so that one can identify the most appropriate strategic position within the industry.

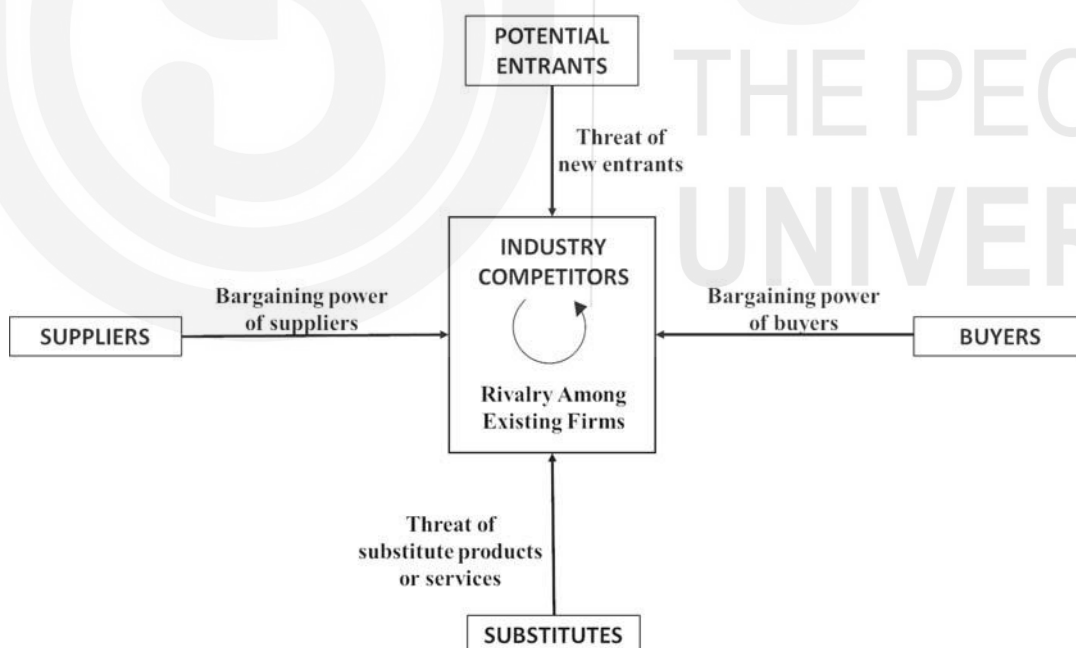


Figure 5.1: Porter's five Forces Model of Competition

1) Threat of New Entrants

Entry of a business organization in and operating in a market is seen as a threat to the established business organizations in that market. The competitive position of the established business organizations is affected because the entrants may add new production capacity or it may affect their market shares. They may also bring additional resources with them which may force the existing business

organizations to invest more than what was not required before. Altogether the situation becomes difficult for the existing business organizations if not threatening always and therefore they resort to raising barriers to entry. These barriers are intended to discourage new entrants and this may be done by organizations, be in any one or more ways, as discussed below:

- a) **Economies of Scale:** Business organizations which operate on a large scale get benefits of lower cost of production because of the economies of scale. Since the new business organization normally would start its operation at a smaller scale and therefore will have a relatively higher cost of production, its competitive position in the industry gets adversely affected. This barrier created through large scale of operation is not only applicable for production side but it can be extended to advertising, marketing, distribution, financing, after sales customer service, raw materials, purchasing and Research and Development as well. For example, you would have noticed in durable industry the kind of investments which players in the durables market do on advertising and promotions normally and especially during events like World Cup cricket match. This makes it nearly impossible for any new third player to launch and sustain such intensive and investment driven marketing attack.
- b) **Learning or Experience Effect:** The theory explaining the experience curve or the learning curve suggests that as business organizations produce more they grow more efficient and this brings them cost benefits. The efficiency levels achieved is an outcome of the experience, which teaches the organization better ways of doing things. This again keeps any new entrant at a disadvantage.
- c) **Cost Disadvantage Independent of Scale:** New entrants may face disadvantages which are independent of the operations. It may be on account of the lack of proprietary product knowledge such as patents, favourable access to raw material, favourable locations, existing plants built and equipped years earlier at lower costs, lower borrowing costs etc.
- d) **Brand benefits:** Buyers are often attached to established brands. Differences in physical or mere perceived value make existing products unique and the new entrants have to really work hard to beat such brands and change the mindset of the customers.
- e) **Capital Requirements:** High investments required for a start up in any business is another deterrent for new entrants bringing down the possibility of increased competition.
- f) **Switching Costs:** Switching costs, which is nothing but the expenses (financial or psychological) which a customer incurs in switching from one seller to another. Cases where such an expense is higher, new entrants find it difficult to establish or survive. Such costs may be because of a strong brand association or the comfort level a customer may be enjoying or it may be on account of a particular technology like different operating systems.

- g) **Access to Distribution Channel:** Any such critical activity like distribution channel in the business can be a barrier for the entrants when accessibility to them is found to be difficult. Most existing business organizations in FMCG industry are found to have a strong favourable distribution channels which is very difficult to penetrate.
- h) **Anticipated Growth:** Incumbents in a rapidly growing market are less likely to respond to a new entrant when the market's growth offers enough opportunities to share. But a new entrant position will be opposite in a slowly growing market.
- i) In addition to the above, few general entry barriers exist in each industry's case, for example, regulatory policies, tariffs and international trade restrictions are few such additional factors.

Activity 1

Identify any industry of your choice and illustrate the possibility of new entrants entering in that industry and why? Do you see any barriers being raised by the existing players?

2) Bargaining Power of Suppliers

Business organizations have a large dependency on suppliers and the latter influence their profit potential significantly. Suppliers' decisions on prices, quality of goods and services and other terms and conditions of delivery and payments have significant impact on the profit trends of an industry. However, suppliers' ability to do all these depends on the bargaining power over buyers.

Suppliers' bargaining power would normally depend on:

- a) **Importance of the Buyer to the Supplier Group:** The size of the supplies taken by a particular buyer is likely to put the buyers in a relatively advantageous position. The same may be found true if the supplier tends to get an image advantage by supplying to a particular business organization. Consequently in dealing with such buyers, suppliers' bargaining power is naturally reduced. Just opposite happens when buyer is not so important to the supplier and the latter then is less likely to offer favourable terms to win or retain the customer.
- b) **Importance of the Supplier's Product to Buyers:** Here the position may just be opposite of the above situation where suppliers have a better bargaining power coming from their sheer size or image.
- c) **Greater Concentration among Suppliers than among Buyers:** An industry, which is largely dominated by a few large business organizations, is a highly concentrated industry. Such few business

organizations hold greater power with them as the proportion of the industry's total output is in hands of such large business organizations. This gives such business organizations greater power over those who do business with them. The converse is true when industry has low concentration in suppliers. A higher concentrated supplier position may be possible on account of the sources of raw materials available, R & D or patent rights available with fewer business organizations.

- d) **High Switching Costs for Buyers:** In this case buyers suffer because of the suppliers' advantageous position or by the nature of supplies itself, the buyers have to face a higher switching cost.
- e) **Credible Threat of Forward Integration by Suppliers:** Suppliers in a given situation may see an opportunity in moving up the value chain and may seriously think of getting into the business of what its buyers have been doing till now. Any indication of that nature from supplier side puts the buyers at the receiving end as they feel threatened because of a new player in that market and of losing an assured source of supplies. A recent example may be of an organization engaged in the petroleum sector which has decided to move from exploration and refining of oil to selling of oil through its own retail petrol pumps.

Activity 2

Identify any industry of your choice and study the suppliers for the industry. Examine their strengths using the parameters discussed above as compared to buyers.

.....

.....

.....

.....

.....

3) Bargaining Power of Customers

Customers with a stronger bargaining power relative to their suppliers may force supply prices down or demand better quality for the same price and may demand more favourable terms of business. For instance, there will always be a difference in the bargaining power between an individual's buying different construction material like cement, steel or bricks and a real estate builder buying them for the number of properties he may have been building over so many years.

Few of the following facts attach greater power to buyers:

- a) **Undifferentiated or Standard Supplies:** A supplier, given the nature of products it supplies, may have a very limited choice in providing any differentiated products and this enables a customer to get the deal at the most favourable terms. In perfectly competitive market situations with large number of suppliers, prices automatically are at their lowest.

- b) **Customer's Price Sensitivity:** Customer's buying behaviour varies with respect to their sensitivity to prices. Depending on how important the item is for the customer's usage and proportion s/he may be spending on the item concerned, buyers' sensitivity to price varies. Any customer with high price sensitivity gains advantage in its bargaining power.
- c) **Accurate Information about the Cost Structure of Suppliers:** A more informed customer is capable of negotiating with suppliers. Whenever such customers notice a decline in the supplier's costs they would always bargain for a proportional decrease in price. This aspect is more relevant in today's context of global markets where cost benefits can come from anywhere in the world at any point in time for various reasons. There may be a general decline in prices of a product in world market because of a glut situation or somewhere some new discoveries may have pulled the prices down.
- d) **Greater concentration in Buyer's Industry than in Supplier's Industry and relatively large volume purchase:** This means that buyers are large and more powerful than suppliers. Government departments like police department when negotiating for large orders of security weapons or intelligence equipments will necessarily command a greater hold than its supplier as there will be only few numbers of such institutions buying them at a given point of time.
- e) **Credible threat of Backward Integration by Buyers:** Different from forward integration which suppliers tend to attempt at, buyers in order to hold their position stronger in the market may integrate in backward manner. This will mean that the buyer extends itself to the previous stage of manufacturing or distribution for which it had been dependent on suppliers till now. An example could be of an entertainment channel which airs programmes outsourced from organizations producing them outside, get into the business of producing its programmes in house.

4) Threat of Substitutes

Often business organizations in an industry face competition from outside industry products, which may be close substitutes of each other. For example, with the new technologies in place now the electronic publishing are the direct substitutes of the texts published in print. Similarly, newspaper finds their closest substitutes in their online version, though it may be a smart strategic move to position them as complementary products.

However, the competitive pressure, which any industry may face, depends primarily on three factors:

- 1) Whether the substitutes available are attractively priced;
- 2) Whether buyers view substitutes available as satisfactory in terms of their quality and performance;
- 3) How easily buyers can switch to substitutes.

Generally it is observed that the availability and acceptability of substitutes determine an upper price limit to a product. When relative prices of the product

in question raise above that of the substitute products, customers tend to switch away from them.

Activity 3

Identify any industry of your choice and study the substitutes for the products of the industry.

.....

.....

.....

.....

5) Competitive Rivalry

The level of rivalry is lowest in a perfectly competitive market where there are large number of buyers and sellers and the product is uniform with everyone. Same is true for a monopoly market where there is only one player and the type of product is also one. However in case of oligopoly or monopolistic competition, where you will find few players and the market conditions allow them to differentiate their products and services, competition is found to be fierce. Few of the following factors explain the level of rivalry:

- a) ***The Stability of Environment:*** An unstable environment is likely to call for a hyper-competitive situation and of the several factors that affect stability could be technological innovation, changes in government regulations, customers' profile and their needs. In an industry which witnesses high movements in terms of entry or exit, the rules of the game may change too frequently. One of such instances of fierce competition could be noticed on account of the onslaught of new technologies. The entry of new technology tends to intensify the rivalry between the players.
- b) ***The Life Expectancy of Competitive Advantage:*** There are industries for example consumer electronics or white goods in which the fruits of innovations do not last longer and hence the companies do not even bother to patent them. This has an adverse implication for the stability of the competitive environment leading to intense rivalry. Length of innovation cycle, patent protection or switching costs between rivals are some factors, which may impact the life expectancy of competitive advantage.
- c) ***Characteristics of the strategies pursued by competitors:*** This also has or may have an impact on the general approach to rivalry. For example, in a market segmented approach on part of the competitor leads to less rivalry. Also the kind of goals, which competitors pursue has an impact on the rivalry. Competitors pursuing the goal of increased market share will lead to increased rivalry again.

Lastly, few implications can be picked up from the five forces framework itself. Lower threats to entry or a higher possibility for substitutes have the potential of

increasing rivalry. A lower engagement between suppliers will result into a lesser rivalry, so will be the effect when buyers face higher switching costs.

In an overall assessment, two critical observations regarding rivalry can be made here. First a powerful competitive strategy employed by one rival can greatly intensify the competitive pressure on other rivals. Second, the frequency and rigor with which rivals use any or all competitive weapons at their disposal can be a major determinant of whether the competitive pressures associated with rivalry are cutthroat, fierce, strong, moderate or weak.

Activity 4

Identify two separate industries, which you may consider are relatively stable and unstable respectively. Comment on the nature of rivalry, which may exist in those industries.

.....

.....

.....

.....

.....

5.4 STRATEGIC GROUPS

They are conceptual clusters in the sense that they are grouped together for purpose of improving analysis and understanding competition within their industry. They do not necessarily belong to any formal group such as an industry, trade, association or any strategic alliances and they do not necessarily differ in their average profitability.

Research has shown that industries vary greatly in the similarity of their business organizations in terms of strategies pursued and we need to analyze the two types of industries differently. For industries, which are considered heterogeneous comprising multiple strategic groups, it would be inappropriate and misleading to combine different strategic groups in the same environmental analysis. For example in a four-wheeler automobile industry, strategic groups can be thought of Cars, Multi-utility Vehicles (MUVs) or Sports car vehicles.

Strategic groups are merely conceptual clusters in order to facilitate analysis and therefore the categorizing of business organizations may be in a way beneficial or insightful. Size of the business organizations may be one of the criteria when analysis is to be understood how giants differ from smaller business organizations. Geographic distribution, breadth of markets, products/ service quality may be few others to determine strategic groups. Furthermore it often makes sense to use different combinations of strategic dimensions to more precisely identify groups.

In a homogeneous industry it is reasonable for all the competitors to be considered as part of the same strategic group in a single industry-wise analysis.

Competitive Intelligence

It is the information which is relevant to strategy formulation regarding the environmental context within which a business organization competes. Such intelligence has several uses and these are:

- a) Providing description of the competitive environment that inform strategist and guide strategy formulation;
- b) Challenge common assumption about the competitive environment;
- c) Forecasting future development in the competitive environment;
- d) Identifying and compensating for exposed competitive weaknesses;
- e) Determining when a strategy is no longer viable or sustainable;
- f) Indicating when and how strategy should be adjusted to changing competitive environment.

5.5 SCENARIO PLANNING

Scenarios are tools for ordering one's perceptions about alternative future environments in which today's decisions might be framed. In practice, scenarios resemble a set of stories, written or spoken, built around carefully constructed plots. These stories can express multiple perspectives on complex events; scenarios give meaning to these events. Scenarios are powerful planning tools precisely because the future is unpredictable. Unlike traditional forecasting or market research, scenarios present alternative images instead of extrapolating current trends from the present. Scenarios also embrace qualitative perspectives and the potential for sharp discontinuities that econometric models exclude. Consequently, creating scenarios requires decision-makers to question their broadest assumptions about the way the world works so they can foresee decisions that might be missed or denied.

Within an organization, scenarios provide a common vocabulary and an effective basis for communicating complex – sometimes paradoxical – conditions and options. Good scenarios are plausible and surprising, they have the power to break old stereotypes, and their creators assume ownership and put them to work. Using scenarios is rehearsing the future. By recognizing the warning signals, the threats and opportunities that is unfolding, one can avoid surprises, adapt, and act effectively.

Decisions which have been pre-tested against a range of what may offer are more likely to stand the test of time, produce robust and resilient strategies, and create distinct competitive advantage. Ultimately, the result of scenario planning is not a more accurate picture of tomorrow but better thinking and an ongoing strategic conversation about the future.

Example of Scenario planning in an Energy Producing Business organization

Understanding the business of an energy producing business organization and the environment it faces, Scenario planning can be found useful in the following ways:

- Creating alignment between energy situation and business organization's vision and purpose. ("What is our 21st century business idea?").
- Sparking innovation and new forms of value creation ("What new products and services might replace the traditional one?").
- It will involve many people with ability-to-perceive and/or ability-to-act as effective participants in the process.
- It will provide space for multiple interpretations to make sense of what is happening.
- By including people from a broad spectrum of backgrounds, scenario planning will be capable of creating early breakthroughs in perception and understanding, allowing the business organization to get grip of the new environment it can't escape from.

Implementation of Scenario Planning

A company-wide involvement in Scenario Planning leads to better result in a business organization. A cross-functional team is instituted for the identification and monitoring of issues.

Employees are encouraged to participate on an incentive based process. The onus of refining and final implementation of the suggestions then lies on the cross functional team. With the following steps indicated, you will be getting a better understanding of the whole process:

STEP 1: Identification of the Issues

Understand the effects of external factors on business and these factors can be:

- Technology driven (new product, IT based integration)
- Political (deregulation, instability)
- Economic (sudden downturns, boom)
- Competitive positioning (moves from competitors)

Participants need not limit themselves to above mentioned factors only; any factor that may have an impact on the company is acceptable.

STEP 2: Classification of the Issues

- Support the issue identified with reports/propositions/any other method.
- Determine the uncertainty and kind of impact of the issue.

STEP 3: Analyzing and Problem Solving

Based on above classification a display board of the issues as per their classification can be used to communicate the issue to all and the following sequence can be taken for analysis and finding the solution to the problem. Figure 5.2 depicts the relationship between uncertainty and impact.

HIGH	A. Can be discarded	B. Keep a close watch
LOW	C. Can be used for long-term planning	D. Are of highest concern
	LOW	HIGH
	IMPACT	

Figure 5.2: A matrix between uncertainty and impact

D category: High impact-low uncertainty: These are highest priority issues which need to be addressed immediately and more cautiously. All employees must first focus on these issues.

B category: High risk issues: These issues need to be observed closely and monitored strictly because of high uncertainty involved.

C category: Low impact-low uncertainty: These issues can be used for long term planning.

A category: High uncertainty-low impact: Because of low impact to the organization and high degree of uncertainty involve, these issues can be altogether discarded.

The analysis and problem solution proposition part can be done on an individual or team basis depending upon the interest of the participant(s). All ideas/reports should then be submitted to the cross functional team for further analysis and implementation.

5.6 SOCIAL MEDIA COMPETITIVE ANALYSIS

We now know the concept of competitive analysis. It is a kind of benchmark of the organization's performance against its competitors. In the present competitive world, the organizations are straining hard to stay ahead of the competition. Social media competitive analysis is one way to stay ahead of the competitors and gauge new opportunities and potential threats.

Why is it necessary for organization to go for social media competitive analysis?

Social media competitive analysis helps in:

- Identifying competitors on social media;
- Knowing the social platforms the competitors are using;
- Knowing the ways they are using these platforms;
- Understanding the response towards the social strategy of the competitors;
- Benchmarking the social results against the competition;

- Identifying social threats;
- Finding gaps of one's own social media strategy.

This can be done using scenario planning techniques. The steps used in Social Media Competitors Analysis are:

1. Determine the competitors
2. Information gathering
3. SWOT Analysis
4. Up-to date information

There are many tools which help the organization to develop their social media visibility and perform the competitive analysis.

5.7 COMPETITIVE PROFILE MATRIX

Competitive Profile Matrix (CPM) is a strategic management tool used to compare the organization with its competitors. It tries to highlight the strong and weak points of the organization relative to its competitors. This tool is used to understand the external environment in a better way. This involves four steps which are as follows:

1. Identify critical success factors
2. Assign a weight to each critical success factor
3. Assign the ratings to each organization
4. Assign a score to each organization.

Let us discuss these steps in brief.

- 1. Identify Critical Success Factors (CSFs):** CSFs as the name suggests are the key focus areas which determine the success of an organization in a particular industry. These areas can be internal as well as external in nature. These factors vary among industries and also in the strategic groups. Since these factors include internal as well as external issues, the ratings include the strengths and weaknesses.
- 2. Assign a weight to each critical success factor:** The weights are assigned to each CSF from 0.0 (least important) to 1.0 (highly important). This indicates the degree of importance to a particular factor.
- 3. Assign the ratings to each organization:** The ratings as mentioned earlier means the range from 4-1. The rating scale and its meaning is given below:
 - 4= Major strength
 - 3= Minor strength
 - 2 = Minor weakness
 - 1 = Major weakness

The ratings and weights should be assigned to each organization subjectively. This can be done using benchmarking.

- 4. Assign a score to each organization:** The last step in performing CPM is assigning a score to each organization. This is done by multiplying the rating with the assigned weights. i.e.

$$\text{Score} = \text{Weights assigned} \times \text{rating assigned}$$

Then the total score of the organization is calculated. Total score is the sum total of all the individual scores of organization. Then the scores of each organization are compared and the one with the highest total score is perceived to be stronger than its competitors. Table 5.1 shows a sample of the CPM.

CPM in general provides more internal strategic information and helps the organization in design- making.

Table 5.1: A sample of Competitive Profile Matrix

Critical Success Factors	Weight	Competitor 1		Competitor 2		Competitor 3	
		Rating	Score	Rating	Score	Rating	Score
Online advertising	0.12	3	0.36	3	0.36	4	0.48
Market share	0.12	2	0.24	4	0.48	4	0.48
Credibility	0.12	2	0.24	3	0.36	1	0.12
IT facilities	0.12	3	0.3	4	0.48	4	0.48
Innovation	0.1	4	0.4	3	0.3	1	0.1
Sales per employee	0.1	1	0.1	2	0.2	3	0.3
Advertising	0.08	1	0.08	2	0.16	1	0.08
Supply chain	0.08	4	0.32	2	0.16	2	0.16
Product range	0.05	3	0.15	1	0.05	2	0.1
Cost structure	0.05	1	0.05	3	0.15	4	0.2
New Product	0.05	3	0.15	3	0.15	3	0.15
Customer loyalty	0.01	2	0.02	4	0.04	1	0.01
Total	1.00		2.41		2.89		2.66

If we see the sample we will find that competitor 2 is having the highest score. This means that the competitor 2 is stronger than its rivals in the industry.

5.8 SUMMARY

The competitive analysis in any organization is based on the assessment of its external environment. In this unit we have discussed various aspects of competitive analysis. The focus is on the five forces framework which helps

us in understanding any industry by identifying the strengths of each of the five forces and the nature of competitive pressure that each force generates. It also enables an understanding of the overall structure of competition. The competitive structure of an industry sounds unattractive when rivalry among organizations are strong, there exists low entry barriers and substitutes are more common along with, when both suppliers and buyers command a higher bargaining power. In case of reverse position the competitive structure is found to be lucrative. The Competitive Profile Matrix has been discussed to understand as to how the competitive analysis is performed.

5.9 KEYWORDS

Bargaining Power	: It is decided by the relative strengths or weaknesses between two players or partners.
Learning or Experience Effect	: It suggests that as organizations increases their productivity, they grow more efficient and this brings them cost benefits.
Switching Costs	: These are the expenses (financial or psychological) which a customer incurs in switching from one seller to another.
Concentration in an Industry	: An industry largely dominated by a few large organizations is a highly concentrated industry.

5.10 SELF-ASSESSMENT QUESTIONS

- 1) Explain the competitive environment for any industry and discuss external analysis framework of that industry.
- 2) Explain briefly the five forces framework and use it for analyzing competitive environment of any industry of your choice.
- 3) Write short notes on Strategic groups and Scenario Planning.
- 4) How does the nature of markets determine the competitive rivalry between business organizations? Explain with suitable examples.

5.11 REFERENCES AND FURTHER READINGS

David, R. Fred. (2007). *Strategic Management: Concepts and Cases* Prentice Hall International Inc.

Haberberg, A. & Rieple, A. (2010). *Strategic Management* (2010ed.). New York: Oxford University Press.

Henry, A. E. (2018). *Understanding Strategic Management* (3rd ed.). Oxford, United Kingdom: Oxford University Press.

Johnson, Gerry & Scholes, Kevan. (2004). *Exploring Corporate Strategy*. Sixth edition, Prentice-Hall of India, New Delhi.

Kazmi, A. (2008). *Business Policy and Strategic Management* (3rd ed.). Delhi: Tata McGraw Hill Publishing Co, Ltd.

Kishor, R. M. (2016). *Strategic Management* (2015 ed.). Delhi: Taxmann publication.

Miller, Alex. *Strategic Management, Third edition*. Irwin McGraw Hill.

Nag, A. (2011). *Strategic Management* (1st ed.). Delhi: Vikas publishing house.

Peters, Thomas J. and Robert, H. Waterman, Jr. (1982). *In Search of Excellence lessons from America's Best- Run Companies*, New York: Harper and Row.

Prasad, L.M. (2002). *Business Policy: Strategic Management*. Delhi: Sultan Chand & Sons.

Shrivastava, R. M. (2017). *Management Policy and Strategic Management* (3rd ed.). Mumbai: Himalaya Publication House.

Thompson, A. Arthur, Jr. & Strickland, A.J. III. (2003). *Strategic Management, Concepts and Cases*, Thirteenth edition. Tata McGraw Hill Publishing, New Delhi.

UNIT 6 INTERNAL ANALYSIS

Objectives

After reading the unit you should be able to:

- Understand the concept of internal analysis and its contribution to strategy formulation;
- Understand concept of core competence and guidelines to assess what resources and abilities constitute core competency of an organization;
- Examine type of resources which organizations possess and their strategic importance;
- Understand the concept of value chain framework;
- Assess SWOT analysis.

Structure

- 6.1 Introduction
- 6.2 Resource Based View
- 6.3 The Critical Success Factor
- 6.4 The Value Chain Framework
- 6.5 Comparison Standards
- 6.6 SWOT Analysis
- 6.7 Internal factor evaluation Matrix
- 6.8 Summary
- 6.9 Keywords
- 6.10 Self-Assessment Questions
- 6.11 References and Further Readings

6.1 INTRODUCTION

In previous units in this block you have learnt how the ever changing nature of external environment, both at macro and micro level affect an organization's business. The changes in the environment may create opportunities, which the organizations try to exploit or may bring threats for the organizations, which the latter tries to control or neutralize. However, in order to develop successful strategies to exploit such opportunities or control the threats, analysis of an organization's capabilities is important for strategy making which aims at producing a good fit between a nation's resource capability and its external situation. Internal analysis helps us understand the organizational capability which influences the evolution of successful strategies.

Many of the issues of strategic development are concerned with changing strategic capability better to fit a changing environment. However, looking at strategic development from a different perspective i.e. stretching and exploiting the organizations capability to create opportunities, it again becomes important to understand these capabilities. The above two perspectives together are called the Resource Based View (RBV) of strategy.

Professionals from different organizations suggest that an organization's overall strengths and weaknesses and its ability to execute are often found more important to its performance than environmental factors. Internal capabilities and process execution at times allow organizations to gain competitive edge over competitors even with relatively lesser resources and lesser advantageous position. In this unit we will also discuss the concept of value chain and have a brief understanding of SWOT analysis.

6.2 RESOURCE BASED VIEW

Resource based view (RBV) model was proposed around the end of 20th century. This model particularly focuses on the organizational resources. Initially the model emphasize on the physical as well as human resources and the organizational capabilities to use these resources to either develop unique products and services or capture new markets. Subsequent developments of this model highlight the significance on tacit knowledge which an organization may possess. Tacit knowledge is the kind of knowledge which is usually hidden among the members of the organization. In other words, it is a form of the knowledge about which the members of the organizations are unaware or unconscious. Tacit knowledge can be of immense importance to the organization as it can be a resource which is unique and may be difficult to imitate by the competitors.

RBV model is centred on the concept of resources as the key to superior organizational performances. The managers are required to make strategic decisions based on the resources and capabilities. RBV model adopts the internal perception to explain how an organization's unique internal resources and capabilities serves as a basis for earning above average returns and thereby gaining competitive advantage over their competitors. Therefore, the model uses internal resources and capabilities to develop core competencies as a response to external environment. Resources and capabilities are the driving forces for strategies which are formulated as a measure to cope with the forces of external environment.

As RBV model gives immense importance to resources, therefore, it is essential to learn about resources and their essential features for a better understanding of this model. A resource is something which an organization owns is accessible or can be developed to formulate and execute strategies for improving effectiveness and efficiency. Resource can include tangible assets, intangible assets, core competencies, capabilities, organizational processes, technical know-how and knowledge. Under RBV model, a resource should be heterogeneous and immobile. Heterogeneity implies that the acquired resource should be different from what other organizations have in the industry. On the other hand, immobility implies that the resources are not easy to transfer to various organizations.

Types of Resources

There are three types of resources – **assets, capabilities and competencies**, which have been identified under Resource Based View of the organization (RBV). Strategic thinkers explaining the RBV suggest that the organizations are collections of tangible and intangible assets combined with capabilities to use those assets. These help organizations develop understanding these three types of resources and help us to know how an organization's internal strength and weaknesses affect its ability to compete.

Assets

The factors of production used by organizations in providing its customers with valuable goods and services are called assets. These assets are of two types- tangible assets and intangible assets. Any physical means an organization uses to provide value to its customers are its tangible assets. Similarly, intangible assets are equally valuable for organizations but their physical presence cannot be felt or seen. For example, a brand name is a very important resource for any organization even though it is intangible. Exhibit 1 gives some examples of tangible and intangible assets.

Exhibit 1: Examples of tangible and intangible assets

Examples of tangible assets	Examples of intangible assets
Organization's property and equipment	Brand name, which is trusted
Patents	Knowledgeable workforce
Distribution network	Robust Organization structure
IT network system	Organizational Culture

Capabilities

In order to take full advantage of its assets the organization needs to develop skills, as experience suggests that with similar assets two different organizations may add value of different amount for themselves. This difference can only be explained by the differences in the capabilities in utilizing these assets. For example, in a sector like management education, you will find institutions more or less with similar resources and infrastructure; however, the quality of their output in terms of new professionals for business may be starkly different for different institutions. This is greatly reflected in the type of organizations that pick them up for employment and the kind of job responsibilities they are offered. This difference in output can be explained on account of the skills which these institutions carry with themselves. This position has been found true in case of many Indian organizations as well as the multinational corporations.

Competencies

Most simply put, it refers to the ability to perform. Experts from field of strategy, using the term 'distinctive competencies' refer to the critical bundle of skills that an organization can draw on to distinguish itself from competitors. However, in order to have a better understanding of the concept, you need to understand first

the resources, which are available to an organization and how they differentiate themselves as competencies or core competencies.

Strategic Importance of Resources

- 1) **Available Resources:** These are those resources that are basic to the capability of any organization which can be listed broadly as:

Physical Resources: These can be buildings, machinery or operational capacity. However, the specific condition and capability of each resource determines their usefulness.

Human Resources: Traditionally or in today's knowledge economy both, people are considered as 'the most valuable asset' of an organization. Knowledge and skill of people together prove to be a great asset.

Financial Resources: These can be capital, cash, debtors and creditors and providers of money.

Intellectual capital: These are intangible resources which include the knowledge that has been captured in patents, brands, business systems and relationships with associates. In knowledge economy intellectual capital is considered as a major asset of many organizations. Exhibit 2 shows a relationship between the resources, competencies and the competitive advantage.

Exhibit 2: Resources, competencies and competitive advantage

	Same as Competitors' or Easy to imitate	Better than Competitors' or Difficult to imitate
Resources	Threshold Resources	Unique Resources
Competencies	Threshold competencies	Core competencies

2) Threshold Resources

Organizations need a set of threshold resources to perform in any market and there is a continuous need to improve such resources to stay in business. This becomes inevitable because of the competitors and sometimes the new entrants. We can think of many industries in India like automobile, durable goods, telecom etc. which with the foreign players had to acquire new sets of resources as their threshold resources to survive.

3) Unique Resources

Unique resources as defined in strategy texts are those resources, which critically underpin competitive advantage. Their ability to provide value in product is better than competitor's resources and is difficult to imitate. Just think of a big music stores like M inc. or the ones from different group, the scale and range of collection of music provides uniqueness to these stores as compared to any of the traditional music shop. Some organizations have patented products or services that give them advantage for some service organizations. Unique resources may be particularly the people working in that organization.

4) Core Competencies

We learnt that competencies refer to the ability to perform. The difference in performance between organizations in the same market is rarely explainable by differences in their resource base, since resources can usually be imitated or traded. Superior performance is actually determined by the way in which resources are deployed to create competences in the organization's activities. An organization needs to achieve a threshold level of competence in all of the activities and processes.

Core competencies are activities or processes that critically underpin an organization's competitive advantage. They create and sustain ability to meet the critical success factors of particular customer groups better than other and provide ways that are difficult to imitate.

Now the question arises as to how to assess what constitutes a valuable asset capability or competence. This can be done by testing for scarcity, inimitability, durability and superiority.

Scarcity: This is a very basic test to understand its resource value. Just in case any resource is widely available, then it is not likely to be a source of competitive advantage.

Inimitability: A resource that is easy to imitate is of little competitive advantage because it will be widely available from a variety of sources. e. g. services / designs etc. Inimitability however does not last long and at some point of time competition matches or even betters any offering. However, organizations should make an effort which may temporarily limit imitation. Physical uniqueness, causal ambiguity or scale deterrence are few ways how organizations attempt doing this.

Durability: Hyper competitive market conditions have a tendency to make competitive advantage less and less sustainable. Durability in such situations becomes a more stringent test for valuing resources, capabilities and competencies.

Superiority: Competencies are valuable only if they manifest themselves as competitive advantages and this means that they are superior to those held by rivals. Being good is not enough and an organization must be better than its competitor.

The above points lead to determining how an organization uses internal resources which might be linked to producing a competitive advantage and the resources which actually fit in so as to produce a competitive advantage.

To be heterogeneous and immobile, a resource should have four traits, collectively referred to as VRIO framework. These are:

- Valuable
- Rare
- Inimitable
- Organize

Now, let us discuss these in detail below.

- a. **Valuable:** A resource is considered to be valuable if it either has a cost advantage or provides any differential advantage. For instance, any innovative process of producing a product reduces the overall cost of production, and then such a process will be considered as a valuable resource. Moreover if a technology is used to create a different and unique feature in a product or service, then such a technology will also be considered as a valuable resource.
- b. **Rare:** A resource is considered to be rare if it is distinctive and unique in nature. A resource which is owned by several other organizations in the same industry will not be a rare strategic resource rather it will be considered as a threshold resource. For a resource to be unique, it should be exclusive to the organization. For example, an organization making products based on a specific metal ore which are very scarce in the world will be a rare resource.
- c. **Inimitable:** A resource is considered to be inimitable if it is difficult for other to imitate or acquire. This can be possible if the resource is expensive to copy, requires specific knowledge to operate or has been built or developed over a considerable time period. For example, a production machine built by an organization by investing huge cost and time will be considered to be an inimitable resource.
- d. **Organize:** A valuable, inimitable or rare resource can only be useful for the organization only if the organization knows how to exploit or utilize it for its own advantage. Therefore, organizing a resource properly is important for gaining strategic advantage. An organization cannot acquire, use, or control its resources effectively unless it is properly organized. This is true even for businesses with valuable, rare, and imperfectly imitable resources. A resource cannot be used to build a lasting competitive advantage if it lacks structure.

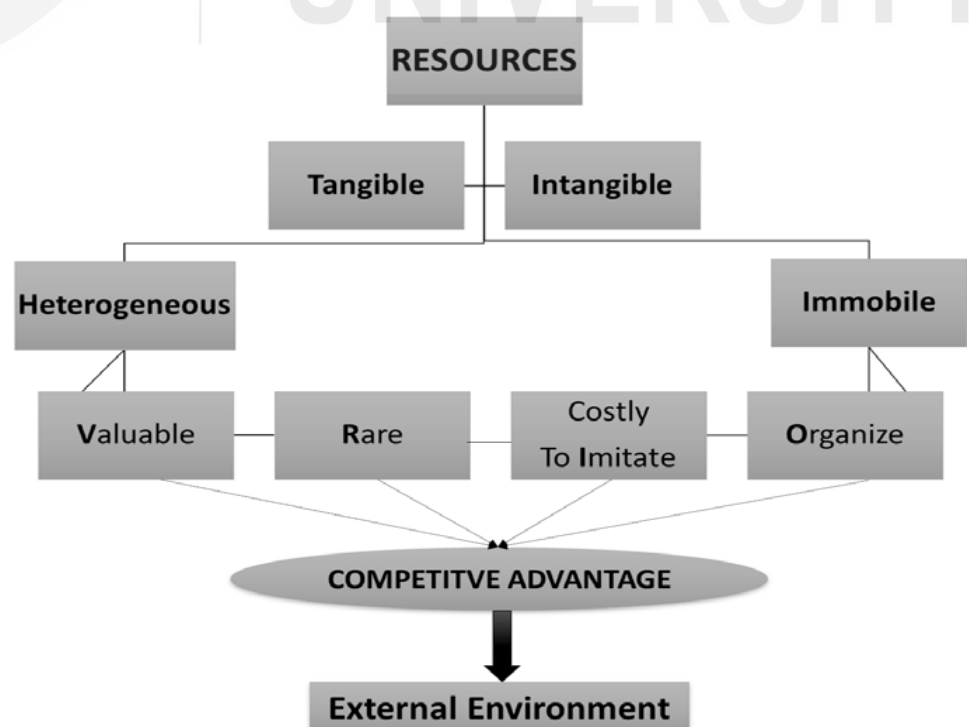


Figure 6.1: Resource Based View Model

The resource based view model indicates that competitive advantage will be achieved by ensuring that resources are developed as per VRIO framework and used to develop strategic response to external environment demands as shown in figure 6.1.

Activity 1

Identify an organization of your choice. Enumerate its threshold resources, unique resources, threshold competencies, core competencies.

.....

.....

.....

.....

Frameworks for Identifying What to Assess

We will now discuss different frameworks to assess the strengths and weaknesses of the organizations. Managers commonly use two frameworks to guide the analysis of organization's strengths and weaknesses – **Critical success factors (CSF)** and **The Value Chain Analysis**.

6.3 THE CRITICAL SUCCESS FACTOR (CSF)

Critical success factors are those which contribute to organization's success in a competitive environment and therefore the organization needs to improve on them since poor results may lead to declining performance. Organizations depending on the environment they operate in and their own internal conditions can identify relevant critical success factors. However, literature on strategy suggests few general sources of critical success factors that have been identified based on empirical research. They are as follows:

Industry Characteristics: Industry specific critical success factors are factors critical for the performance of an industry. For example in hospitality industry excellent and customized service, wide presence and an excellent booking and reservation system is critical. Similarly for airline industry fuel efficiency, load factors and an excellent reservation system are critical.

Competitive Position: Critical success factors for an organization may also be determined by its relative position with respect to its competitors. In some instances, industry is dominated by few large players and their actions lead to determining the critical success factors for the industry which smaller players have to ensure for their success. For example, for the pathological laboratory centers earlier the CSF was authentic, hygienic and scientific testing facilities until few big players added service features like door to door sample collection or home delivery of reports. Very soon approachability and ease became the additional CSFs for the players.

General environment viewed from any of the dimensions may determine the CSFs. Most simply put in years of drought, availability of water is at premium and having access to assured source of water can become the critical success

factor for many industries like tanneries etc. For the same industry considering environmental norms, adhering to anti-pollution standards becomes critical success factor. On many occasions' developments within the organizations, force internal considerations to become temporary critical success factors.

Activity 2

Using the following critical success factors identified for retail industry, pick two large retail stores located in your locality and compare their performance:

Critical Success Factors	Retail 1	Retail 2
1. Low sales and administrative expense		
2. Efficient distribution systems		
3. Reputation for value		
4. Organization culture		
5. Top management turnover		
6. Supplier relationships		

6.4 THE VALUE CHAIN FRAMEWORK

This is the other framework most commonly used to guide analysis of any organization's strengths and weaknesses. In this framework, any business is seen as a number of linked activities, each producing value for the customer. By creating additional value, the organization may charge more or is able to deliver same value at a lower cost, either of this leading to a higher profit margin. This ultimately adds to the organization's financial performance.

The value chain framework as shown in figure 6.2 is a typical value chain within an organization. Using this framework, it is possible to analyze the organization's contributions of individual activities in a business and how they add up to the overall level of customer value, the organization produces.

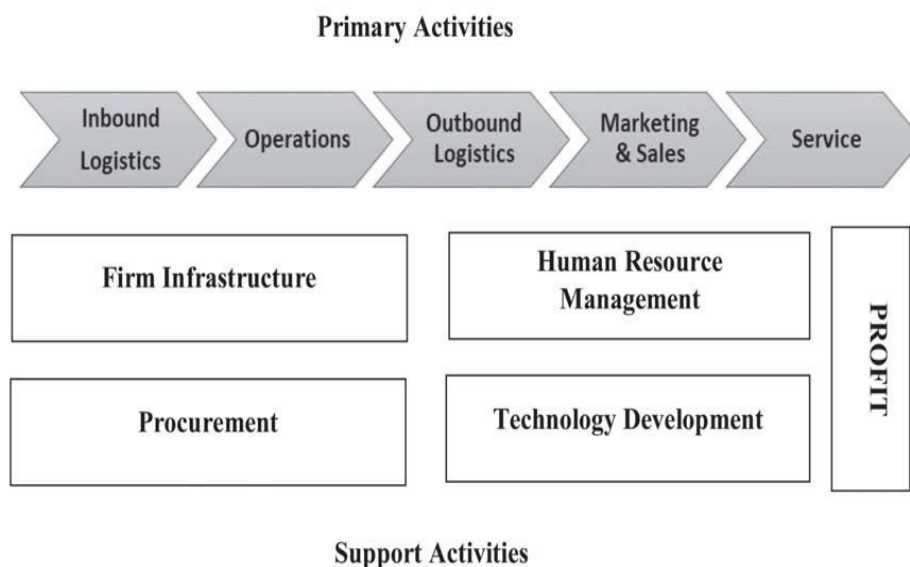


Figure 6.2: Porter's Value Chain Model

It is divided into two parts i.e. primary activities and support activities. The primary activities constitute of the following:

- a) **Inbound Logistics** are activities concerned with receiving, storing and distributing the inputs to the product or service. They include materials handling, stock control, transport etc.
- b) **Operations** transform various inputs into the final product or service like manufacturing, packaging, assembly testing etc.
- c) **Outbound Logistics** collect, store and distribute the product to customers. For tangible products this would be warehousing, materials handling, transportation etc. In the case of services they may be more concerned with arrangements for bringing customers to the service if it is a fixed location (e.g. entertainment show).
- d) **Marketing and Sales** makes consumers/ users aware of the product or service so that they are able to purchase it. This includes sales administration, advertising, selling and so on.
- e) A **services** activity helps improving the effectiveness or efficiency of primary activities.

Each of the groups of primary activities is linked to support activities which are as follows:

- a) **Procurement:** This is a process for acquiring the various resource inputs to the primary activities and this is present in many parts of the organization.
- b) **Technology Development:** There are key technologies attached to different activities which may be directly linked with the product or with processes or with resource inputs.
- c) **Human Resource Management:** This is an area involved with recruiting, managing, training, developing and rewarding people within the organization. This categorization of the activities as primary or support may be found true for organizations in general; however it is always better to have one's own judgment in identifying activities for particular organizations in consideration.

Exhibit 3 shows some of the guiding points for evaluating primary activities.

Exhibit 3: Select guiding points for evaluating primary activities

- | |
|--|
| <ol style="list-style-type: none"> a) Inbound Logistics <ul style="list-style-type: none"> • Soundness of material and inventory control systems • Efficiency of raw material warehousing activities b) Operations <ul style="list-style-type: none"> • Productivity of equipment compared to that of key competitors • Appropriate automation of production processes |
|--|

- Effectiveness of control systems to improve quality and reduce cost
- Efficiency of plant layout and work flow design
- c) **Outbound Logistics**
 - Timeliness and efficiency of delivery of finished goods and services
 - Efficiency of finished goods warehousing activities
- d) **Marketing and Sales**
 - Effectiveness of market research to identify customer segments and needs
 - Innovation in sales promotion and advertising
 - Evaluation of alternate distribution channels
 - Motivation and competence of sales force
 - Development of an image of quality and a favourable reputation
 - Extent of market dominance within the market segment or overall market
- e) **Customer Service**
 - Means to solicit customer input for product improvements
 - Promptness of attention to customer complaints
 - Appropriateness of warranty and guarantee policies
 - Ability to provide replacement parts and repair services

Exhibit 4 shows some guiding points for evaluating support activities.

Exhibit 4: Select guiding points for evaluating Support activities

Organization Infrastructure

- Coordination and integration
- Level of Information system
- Quality of planning system
- Timely and accurate information on environment

Human Resource Management

- Effectiveness of recruitment, training procedures
- Appropriateness of reward systems
- Relationship with trade unions
- Level of employee motivation and job satisfaction

Technology Development

- Success of R & D environment

- Quality of laboratories and other facilities
- Ability of work environment
- Qualification and experience of technical hands

Procurement

- Sources of raw material – time, cost, quality
Procedures for procurements
- Relationships with reliable suppliers

With the indicative guiding points, you must have realized how with the Value Chain Framework, organizations can use these indicators as a reference point in order to improve its overall ability to create value. Miller suggests that the value chain framework can also be useful in a broader sense while deciding in what and where to specialize in the value activities from product design to the delivery of the final product or service to the final consumer.

Activity 3

Suppose there is an organization which is into fast food business with home delivery facility. Identify the critical success factors for this particular organization's success.

.....

.....

.....

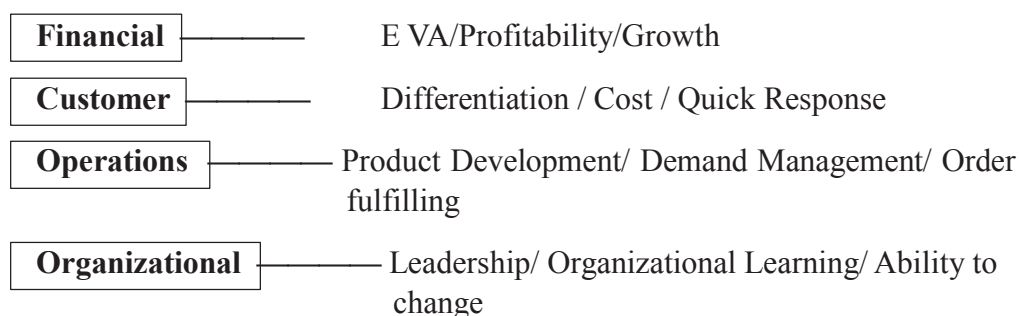
.....

.....

The Balance Scorecard

This concept offers a well-rounded evaluation that views the organization from different complimentary perspectives as is shown below:

The four perspectives of the Balanced Scorecard are



Source : Adapted from Miller (1998)

Looking at the flow chart we can very well understand that performance as assessed in one perspective supports performance in other areas and therefore we need to consider all four perspectives in carrying out a complete internal analysis.

6.5 COMPARISON STANDARDS

In order to arrive at some meaningful conclusion regarding strengths and weaknesses, the above analysis should be supported by appropriate standards for comparison, for example, Industry norms, Historical performance and Benchmarks. These are three commonly accepted comparison standards which are often found useful for internal analysis by the organizations.

Industry Norms

The industry norms compare the performance of an organization in the same industry or sector against a set of agreed performance indicators. Data on industry norms are widely available and can be found from several published sources. Using such data and comparing an organization against others in its industry helps the organization understand its true position. In case of the healthcare sector, such indicators can be mortality index, doctors per 100 beds, nurses per 100 beds, waiting time per in- patient's treatment, waiting time per outpatient treatment, patient's trust in doctors.

The danger of industry norms comparison is that the whole industry may be performing badly and losing out competitively to other industries. Another problem with such comparisons may also arise as the boundaries of industries are coming down through competitive activity and industry convergence. For example publishing houses are evolving into multiple media groups working around the infotainment industry.

Moreover talking of industry norms, it is an average indicator and organizations must endeavour in beating them rather meeting them. In order to understand how they have been doing so it is always suggested that industry norm comparisons are supplemented with analysis on organization's own historical performance.

Historical Comparisons

Historical comparisons look at the performance of an organization in relation to previous years in order to identify significant changes. Organizations must endeavour to improve their performance over time in order to remain competitive and overpower the performance of competitors. It must try to beat its own best in future, which would call for continuous improvement.

However in case of the historical comparison it also entails scope for complacency since the organizations compare their rate of improvement over years with that of competitors and it is possible that the latter may itself be operating at a relatively lower average. Such historical trends can even be misleading when they entail changes made on a very small base.

Benchmarking

Benchmarking compares an organization's performance against 'best in class' performance wherever that is found. Managers seek out the best examples of a particular practice in other organizations as part of an effort to improve the corresponding practice in their own organization.

When the search for best practices is limited to competitors, the process is called competitive benchmarking. Other times managers may seek out the best practices

regardless of what industry they are in, called functional benchmarking. Benchmarking provides the motivation and the means many organizations need to seriously rethink how their organizations perform certain tasks.

A comprehensive internal analysis of an organization's strengths and weaknesses must however utilize all three types of comparison standards. For instance, an organization can study industry norms to assess where it stands in terms of number of complaints generated regarding defects during guarantee period of a product. Then it could benchmark the organization that is best at controlling the defects. Based on the benchmarking results it could implement major new programmes and track improvements in these programmes over time using, historical comparisons.

6.6 SWOT ANALYSIS

Strengths

SWOT stands for Strengths, Weaknesses, Opportunities and Threats. A SWOT analysis summarizes the key issues from the external environment and the internal capabilities of an organization those which become critical for strategy development. The aim through this is to identify the extent to which the strengths and weaknesses are relevant to and capable of dealing with changes in the business environment. It also reflects whether there are opportunities to exploit further the competencies of the organization.

Internal Environment	S Strengths	W Weakness
External Environment	O Opportunities	T Threats

Figure 6.3: SWOT Analysis

How to perform a SWOT Analysis in organizations?

We know that SWOT analysis is assessing the internal as well as external environment of an organization. Let us see an example of X Corporation which is into manufacturing software. Exhibit 5 shows the SWOT analysis of X Corporation.

Exhibit 5: SWOT ANALYSIS FOR X CORPORATION

SWOT FOR X CORPORATION			
STRENGTHS	WEAKNESSES	OPPORTUNITIES	THREATS
• High quality products • Good reputation • Learning from mistakes and producing better products • Highly competitive • Competitive pricing • Low production cost	• Into loss making • Sales slowing down • No sense of direction • Decrease in productivity • No proper collaboration within the functional departments	• Increase in the size of engineering division. • Original work • Increase in promotional techniques • Trying to sell high quality products cheaper • May expand its operations • Increase in demand of products • Overseas demand • Favourable government policies	• Competitors like Y corporations • Reports show that some of its products are fake, decline in reputation • Lacks proper strategy • Losing to competitors due to the complexity of products • Entry of new substitutes in market • Inflation in raw material cost

6.7 INTERNAL FACTOR EVALUATION MATRIX

The Internal factor Evaluation Matrix (IFE) is used as a strategic tool to evaluate the internal environment of the organizations. This tool evaluates the major strengths and weaknesses of the organization in the functional areas of a business. It also provides a basis for assessing the relationship among those areas. This involves five steps which are as follows:

1. List key internal factors
2. Assign weight to each factor
3. Assign a rating to each factor
4. Determine a weighted score
5. Determine the total weighted score.

Let us see how each step is to be performed to find out the IFE. Table 6.1 gives an example of IFE.

1. **List key internal factors:** Around 10 or 20 key internal factors are to be identified which determine the strengths and weaknesses for the organization. Then the listing of all the strengths and weaknesses is done.

2. **Assign weight to each factor:** In this step each factor is assigned weights ranging from 0.0 (not so important) to 1.0 (very important). These weights depict the relative importance to each factor for being successful in the industry. The weights are industry based and the sum of all weights should be 1.0.
3. **Assign rating to each factor:** A rating in the scale of 1 to 4 is assigned to each factor and these are organization based. The rating scale is as follows:
 - 1 = major weakness
 - 2 = minor weakness
 - 3 = minor strength
 - 4 = major strength
4. **Determine a weighted score:** This step involves multiplying weight of each factor by its rating.
5. **Determine the total weight score:** In this step a sum of the weighted score of each variable is calculated.

In IFE matrix it is important to note that the total weighted score can be as low as 1.0 and as high as 4.0 and the average score should be 2.5. a score below 2.5 indicates a weak internal position and a score above 2.5 indicates a strong internal position of the organization. Table 6.1 shows a sample of IFE Matrix.

Table 6.1: A sample of Internal Factor Evaluation Matrix

	Key Internal Factors	Weight	Rating	Weighted Score	
STRENGTHS	Diversified income	0.08	3	0.24	1.92
	Credibility	0.1	4	0.4	
	Number of patents	0.02	3	0.06	
	HR advantage	0.07	4	0.28	
	Competency in takeovers	0.06	3	0.18	
	Diversified products	0.11	4	0.44	
	SCM	0.08	4	0.32	
WEAKNESS	Level of debts	0.1	1	0.1	0.82
	Sales only from one product	0.13	2	0.26	
	Margins of profits	0.07	2	0.14	
	Price competitiveness	0.09	2	0.18	
	Culture	0.04	1	0.04	
	Impact of external environment	0.05	2	0.1	
	Total	1.00	2.74		

6.7 SUMMARY

Understanding of the strengths and weaknesses of an organization comes through the internal analysis. This is important for any organization in order to respond effectively to its environment both micro and macro. Also understanding them enables the organization to stretch its capabilities and create new opportunities for themselves. However managers have to work hard in assessing the capabilities using frameworks like Critical success factors and the Value chain analysis and analyzing them through quantitative or qualitative analysis. The end result goes as an important input for SWOT analysis.

6.8 KEYWORDS

Tangible Assets	: Any physical means a organization uses to provide value to its customers.
Intangible Assets	: are equally valuable for organizations but their physical presence cannot be felt or seen.
Competencies	: refers to the ability of an organization to perform.
Core Competencies	: are activities or processes that critically underpin an organization's competitive advantage.
Critical Success Factors	: are those which contribute to organization's success in a competitive environment.
Financial Quantitative Analysis	: traditionally financial analysis emphasizes on the study of financial ratios which is commonly known as ratio analysis.
Industry Norms	: compare the performance of an organization in the same industry or sector against a set of agreed performance indicators.
Benchmarking	: compares an organization's performance against 'best in class' performance.
SWOT	: stands for Strengths, Weaknesses, Opportunities and Threats.

6.9 SELF-ASSESSMENT QUESTIONS

- 1) Explain and identify the type of resources which an organization may possess.
- 2) What do you understand by the term critical success factor and what is the core competency of an organization?
- 3) Why is Resource Based View important for organizations? Discuss.
- 4) Briefly discuss the value chain framework.
- 5) Identify the difference of various comparison standards and explain how they can be important for internal analysis?
- 6) Perform a SWOT analysis for an organization of your choice.

6.10 REFERENCES AND FURTHER READINGS

Haberberg, A. & Rieple, A. (2010). *Strategic Management* (2010 ed.). New York: Oxford University Press.

Henry, A. E. (2018). *Understanding Strategic Management* (3rd ed.). Oxford, United Kingdom: Oxford University Press.

Johnson Gerry & Scholes Kevan. (2004), *Exploring Corporate Strategy*, Sixth edition, Prentice-Hall of India, New Delhi.

Jr. Thomson A. Arthur, III Strickland A.J. (2003), *Strategic Management, Concepts and Cases*, Thirteenth edition, Tata McGraw Hill Publishing, New Delhi.

Kazmi, A. (2008). *Business Policy and Strategic Management* (3rd ed.). Delhi: Tata McGraw Hill Publishing Co, Ltd.

Kishor, R. M. (2016). *Strategic Management* (2015 ed.). Delhi: Taxmann publication.

Miller, A (1998), *Strategic Management*, Third edition, Irwin McGraw Hill.

Nag, A. (2011). *Strategic Management* (1st ed.). Delhi: Vikas publishing house.

Prasad, L.M. (2002). *Business Policy: Strategic Management*. Delhi: Sultan Chand & Sons.

Shrivastava, R. M. (2017). *Management Policy and Strategic Management* (3rd ed.). Mumbai: Himalaya Publication House.

THE PEOPLE'S
UNIVERSITY

The background of the page features a large, light gray watermark of the Open University logo. The logo consists of a stylized 'U' and 'O' forming a circular emblem, with the text 'Open University' and 'THE PEOPLE'S UNIVERSITY' integrated into the design.

BLOCK 3

FORMULATION OF STRATEGY

BLOCK 3 FORMULATION OF STRATEGY

This block discusses these three strategies in brief. These are:

Unit 7: Business Level Strategy: Business level strategies are popularly known as generic or competitive strategies. Michael E. Porter classified these strategies into overall cost leadership, differentiation and focus. The first two strategies are broader in concept as their competitive scope is wide enough and the third strategy i.e., the focus strategy has a narrower competitive scope.

Unit 8: Competitive Strategy: In this unit the formulation of competitive strategies is discussed in different situations. This unit will help you to understand different competitive moves taken by the organizations to make its strategy effective and the different dimensions of competitive strategy.

Unit 9: Corporate Level Strategy: deals with the concept of strategy at corporate level and also explains different types of growth strategies. The major stress in this unit is on different types of expansion strategies and the rationale for implementing these strategies.



ignou
THE PEOPLE'S
UNIVERSITY

UNIT 7 BUSINESS LEVEL STRATEGIES

Objectives

After reading this unit, you should be able to:

- Acquaint yourself with the concept of cost and its role in business growth.
- Understand the cost leadership strategy;
- Understand the concept of differentiation;
- Understand the concept of focus.

Structure

- 7.1 Introduction
- 7.2 Role of Cost in Business Growth
- 7.3 Overall Cost Leadership
- 7.4 Differentiation
- 7.5 Types of Differentiation
- 7.6 Cost of Differentiation
- 7.7 Advantages and Disadvantages of Differentiation
- 7.8 Focus
- 7.9 Summary
- 7.10 Keywords
- 7.11 Self-Assessment Questions
- 7.12 References and Further Readings

7.1 INTRODUCTION

Business level strategies are a set of certain moves and action which are taken with aim to provide value to the customers thereby developing a competitive advantage. The organization gets this competitive advantage by using the core competencies of an organization. Such strategies usually occur in the organizations having multiple businesses where each business is considered to be a Strategic Business Unit (SBU). Therefore, these strategies are the actions specifically selected for each SBU. The business level strategies try to address the following issues:

- Satisfying the customer needs;
- Achieving an edge over its competitors;
- Avoidance of competitive disadvantage.

Michael Porter in his book *Competitive Advantage* (1998) suggested three generic competitive strategies aiming to develop a dependable position in the long-run

and out-perform the competitors. These three strategies are: Cost Leadership; Differentiation; and Focus. All the three strategies can either be used individually or in combination to each other.

Cost analysis occupies an important place in business strategy. In order to gain and sustain competitive advantage, an organization should not only monitor its cost performance but also should endeavor to control it. Several strategic decisions like fixation of competitive prices, provision of after-sale services, quality of the products etc. depend upon relative cost level of the business organization.

Cost leadership stresses on producing quality products at low cost for the consumers who are price sensitive. Differentiation is a strategy, which is directed at producing goods and services considered unique in its industry and directed at consumers who are relatively price-insensitive. Focus strategy concentrates on producing products and services that fulfill the needs of small groups of consumers and is based on segmentation. To gain competitive advantage, it is essential for the organizations to transfer skills and expertise among autonomous business units effectively. The competitive advantages in cost leadership, differentiation and focus can be achieved depending on factors like; type of industry, size of organization, and nature of competition.

Differentiation strategy is more of a positioning strategy whereby the organization tries to be unique in its industry by positioning itself along certain dimensions. The degree of differentiation varies with different strategies. Differentiation is industry-wide whereas focus strategy is based on a segment or group of segments in the industry. There are two variants of focus strategy, which are cost focus and differentiation focus. This unit discusses all these aspects.

7.2 ROLE OF COST IN BUSINESS GROWTH

You have noted that costs play an important role in the survival and growth of a business organization. For survival, a business organization must make some profit so that it can sustain its operations on a long-term basis and fulfill its other obligations. Before a business starts operating, it has to incur certain initial costs for acquiring assets, such as land, building, plant and equipment. These assets have to be installed and commissioned. Then the raw materials are paid for and fed into the machines so that the finished goods can be produced. These are then sold in the market to generate revenue. A part of this revenue is used for repaying installments towards loans and other borrowings. The shareholders also expect certain returns in the form of dividends on the equity held by them.

It is presumed that, after meeting such expenses, the organization is left with some revenue to buy the raw materials and other needed utilities so that it can run the next operating cycle of the business process. The survival and growth of the business organization, to a large extent, depends on what the organization pays for its fixed costs and what contribution it generates after meeting all the expenses.

Apportioning of the fixed costs incurred by the organization in starting a business depends on the volume of its operations. A lower volume of products puts a heavy burden on each unit produced. A larger volume of operations reduces the cost per unit. The total variable cost, which varies with the volume produced, may also reduce, as a consequence of the Experience Curve Effect.

Let us understand this concept through some examples:

- A large manufacturing organization initially entered only into the largest product segment, i.e. truck tyres and aimed at dominant market share. Their latest technology helped them. They initially priced their products lower than industry leaders, and offered “good value for money” to truck operators. Subsequently they matched the market leaders’ price and displaced by capturing higher market share.
- A FMCG organization has used relative cost advantages in three areas: production, distribution and promotion. By adopting semi-manual production process and concentrating in the North and West Zone urban markets, and by cost effective distributor incentive schemes and advertising spots on national radio (initially), they kept their costs low in three areas and offered a highly price competitive product.
- A cycle manufacturing organization dropped the irrelevant product attributes and by sub-contracting the production of parts to small units, achieved cost advantages which helped the company in processing their products very competitively.

Activity 1

Think of more such success stories and comment on their competitive strategy.

.....

.....

.....

.....

7.3 OVERALL COST LEADERSHIP

The organizations operating in this highly competitive environment are always on the move to become successful. To strive in this competitive environment the organizations should have an edge over the competitors. To develop competitive advantage, the organizations should produce good quality products at minimum costs etc. This means that the organizations should provide high quality at low cost so that the customer gets the best value for the product s/he is buying. Therefore, it becomes necessary for the organizations to have a strategic edge towards its competitors. One such generic strategy is overall cost leadership, which aims at producing and delivering the product or service at a low cost relative to its competitors at the same time maintain the quality. According to Porter, following are the prerequisites of cost leadership:

- 1) Aggressive construction of efficient scale facilities;
- 2) Vigorous pursuit of cost reduction from experience;
- 3) Tight cost and overhead control;
- 4) Avoidance of marginal customer accounts;
- 5) Cost minimization.

According to Porter cost leadership is perhaps the clearest of the three generic or business level. To sustain the cost leadership throughout, the organization must be clear about its accomplishment through different elements of the value chain. Figure 7.3 shows a matrix of the three generic strategies and their interrelationship as given by Porter.

		Strategic Advantage	
		Uniqueness as perceived by customer	Low Cost Position
Strategic Target	Industry wide	DIFFERENTIATION	OVERALL COST LEADERSHIP
	Specific Segment Only	FOCUS	

Figure 7.1: Three Generic Strategies

Source: Adapted from Porter (2008)

The low-cost leadership strategy at times enables the organization to defend itself against each of the five competitive forces. If we see the concept of cost-leadership in the Indian context, we find that it had worked wonders with textile industries, pharmaceuticals and telecomm. This shows that a cost leader, however, cannot ignore the bases of differentiation.

Activity 2

Scan the business dailies or any of the business magazines available and prepare a case study of any of the business organization, which has become successful in the recent past by adopting cost leadership strategy.

Though, low cost can be one of the most important competitive advantages enjoyed by organizations all over the globe but it does have its drawbacks. Some of the drawbacks can be listed as follows:

- Initiation by the competitive organizations;
- Threat of competitive organizations from other nations;
- Organization losing cost leadership due to fast technological changes, which require high capital investment;
- Threat by competitors to capture still lower cost segments; competition based on other than cost.

Looking at these drawbacks, one can say that cost leadership strategy has to be adopted keeping in mind, the risks involved and develop an overall effective cost-strategy.

7.4 DIFFERENTIATION

Every individual customer is unique in itself so is his/her preferences regarding tastes, preferences, attitudes, etc. These needs of the customers are fulfilled by the organizations by producing differentiated products. In our day-to-day life we see many such examples of differentiated products. Most of the fast moving consumer goods like biscuits, soaps, toothpastes, oils, etc. come under the category of differentiated products. To satisfy the diverse needs of the customers, it becomes essential for the organizations to adopt a differentiation strategy. To make this strategy successful, it is necessary for the organizations to do extensive research to study the different needs of the customers. An organization is able to differentiate from its competitors if it is able to position itself uniquely at something that is valuable to buyers. Differentiation can lead to **differential advantage** in which the organization gets the premium in the market, which is more than the cost of providing differentiation. The extent to which the differentiation occurs depends on the overall strategy of the organization. Previously differentiation was viewed narrowly by the organizations, but in the present scenario it has become one of the essential components of the organization's strategy.

When we talk of differentiation, it can be said that virtually any product can be differentiated. The greatest potential of differentiation lies in products, which are of complex nature but do not have to adhere to strict regulatory standards, but the success of a differentiation strategy depends on the organization's commitment towards customers and the understanding of customer needs as differentiation is all about perceiving on the part of the customer of something unique. Differentiation can be said to have more competitive advantage than the cost advantage as it is quite difficult to imitate the differentiated products. Even if the initiation is done in terms of concept, then also a particular product remains unique regarding its value, style, packaging, etc. Therefore, when we talk about differentiation, it is important to understand the demand of the customers and fulfilling this demand keeping in mind the differentiation advantage. In this case, one thing the organizations should concentrate on is creativity and innovativeness than on market research. We have discussed about the concept of differentiation as a whole but we need to know the why aspect of differentiation, i.e., why do the organizations need differentiation?

Need

There are a number of reasons depending on the nature of organization to adopt a differentiation strategy. It is not necessary that the organization should and must go for differentiation strategy if it does not require one. The requirement is need based and depends on the organization's position in the market. There are a number of factors which result in differentiation. Some of them are as follows:

- To compete against the rivals;
- To create entry barriers for newcomers by building a unique product;
- To reduce the threats arising from the substitutes;
- To develop a differentiation advantage.

Looking at these reasons, one can say that differentiation indeed helps the organizations to get a competitive advantage over its rival organizations.

Activity 3

Give the examples of any three major organizations, which have achieved differentiation advantage by adopting differentiation strategy. Do name the differentiated products they are offering.

.....

.....

.....

.....

.....

.....

7.5 TYPES OF DIFFERENTIATION

Differentiation can be classified into two basic types vis a vis.

- Tangible differentiation
- Intangible differentiation

As the name suggests, tangible means, something which is real and can be seen, touched, etc. whereas intangible means, something which is abstract in nature and cannot be touched, it can just be felt. We have already discussed the tangible aspect. In fact most of the time while discussing differentiation, we actually discuss the tangible differentiation. Table 7.1 shows some of the opportunities available for creating uniqueness within the organization. These opportunities in one way or the other measure the performance of the organization, but when these opportunities are related to the customer's psychology, the intangible aspect to differentiation comes into the picture.

Table 7.1: Opportunities for Creating Uniqueness within the Organization

Activity	Differentiation opportunity
Purchasing Design	Quality of components and material acquired Aesthetic appeal Robustness of performance Ease of maintenance
Manufacturing Delivery	Minimization of defects Speed in fulfilling customer orders Reliability in meeting promised delivery items
Human Resource Management	Improved training and motivation increases customer service capability
Technology Management	Permits responsiveness to the needs of specific customers
Financial Management Marketing	Improves stability of the organization Building of product and company reputation through advertising
Customer Service	Providing pre-sales information to customers

Source: Adapted from Sadler (2004)

Projecting an image about a particular product is one form of intangible differentiation. This can be done with the help of packaging, style, etc. This shows that tangible as well as intangible differentiation goes hand in hand and either of them cannot exist independently. Exhibit 1 show some tangible and intangible components, which result in differentiation of a particular product.

Exhibit 1: Tangible and Intangible Components of Differentiation

Tangible	Intangible
Design	Image
Packaging	Brand
Style	Company reputation
Quality	Customer preferences

Intangible differentiation is more effective in those cases where the customer has once experienced the product, for example, chocolates. Every brand has a unique taste, different packaging style, etc. This is the case where quality can be judged only after using the product once but in case where the quality cannot be judged by experience, e.g., medical services, the intangible differentiation is not that effective. In short, it can be said that intangible differentiation is accompanied by tangible differentiation.

7.6 COST OF DIFFERENTIATION

Differentiation is usually costly. The differentiation adds costs as it involves added features to cater to the needs of the customers. Usually the cost is incurred in the following cases:

- Increased expenditure on training;
- Increased advertising spend to promote the product;
- Cost of hiring highly skilled sales force;
- Use of more expensive material to improve the quality of the product, etc.

There can be many more cost drivers depending on the nature of the organization's activity. It is not necessary that differentiation is always costly. Some differentiation is surely costly but if the value activities are coordinated properly, the costs can be minimized. The cost of maximizing profits by minimizing costs can surely be achieved. It is believed that differentiation in having more product features can be more costly than having different but more desired features. Similarly, for bigger products, differentiation is likely to be less costly than for the small products like soaps. The cost of differentiation more or less depends on the cost drivers. The cost drivers determine the uniqueness of the differentiation activity for a particular organization. The different forms of differentiation have different effect of cost drivers. But the crux of the whole concept is that the cost be minimized to achieve an appropriate differentiation strategy, which gives a premium price for the product. Though it is very difficult to develop a trade-off

between differentiation and cost efficiency but not impossible. This practice is very popular in case of automobile industry where different organizations have many variants but the difference is basically related to the features of the product.

With the world becoming smaller due to high technological innovations, differentiation strategies adopted by many organizations is accompanied by computer aided work culture. Though application of modern technology increases the cost but on the other hand, the labour cost is reduced to a large extent and technical efficiency achieved is very high. The economies of scale can be exploited to a large extent with the help of a trade-off between cost and differentiation.

7.7 ADVANTAGES AND DISADVANTAGES OF DIFFERENTIATION

Everything is accompanied by advantages and disadvantages and so is differentiation.

Let us first discuss the advantages of differentiation followed by its disadvantages.

Advantages

- Premium price for the organization;
- Increase in number of units sold;
- Increase in brand loyalty by the customers;
- Sustaining competitive advantage.

Premium price for the organization: When the organization is able to exploit all sources of differentiation that are less costly or are not costly, then the organization can differentiate from its rival organizations. There can be many examples like changing the mix of product features than adding more features, which are less costly but differentiate the product giving a competitive advantage, i.e., the price premium to the organization.

Increase in number of units sold: If the product is unique then the demand for it increases, henceforth increasing the number of units sold. A very good example is of a Noodle Company, which has competition from the big companies, but is still considered to be different from its rivals. Here, the number of customers is won by smart differentiating strategy, thereby increasing the number of units sold.

Increase in brand loyalty by the customers: A well-positioned and differentiated product gains the brand loyalty of the customers. For example, a large coffee brand has developed a brand loyalty amongst coffee lovers. First, it came in powdered form, but it differentiated itself by coming in granular form then it moved to decaf version and the pre-mix in different flavours, maintaining the quality. Once experienced, the brand loyalty or customer loyalty for a particular brand is developed.

Sustaining competitive advantage: Last, but not the least, this is the crux of the differentiation. This can be achieved by optimizing cost and increasing profits. It is more often known as low-cost differentiation strategy. It is the combination of all three advantages discussed above.

Looking at these advantages, one can say that capitalizing the buyer/customer value is the most important. The organizations must concentrate on those activities which affect the customer value than the ones which do not.

Disadvantages

It is not necessary that every time the organization goes for differentiation strategy, it is successful. At times there are disadvantages associated with it. Some of the most common disadvantages are:

- Uniqueness of the product not valued by buyers;
- Excess amount of differentiation;
- Loss due to differentiation.

Uniqueness of the product not valued by buyers: There are a number of cases where the differentiated product has not gained importance by the customers, hence failed to position itself in the market. Uniqueness necessarily does not lead to differentiation. More important is the perception of buyers regarding a particular product.

Excess amount of differentiation: Too much of anything is bad. Same is the case with differentiation. If the organization is unable to understand the customer needs and preferences but goes on differentiating the product, then the organization loses its market value. Unnecessary differentiation results in failure.

Loss due to differentiation: In certain cases the organization while differentiating does not realize the importance of coordinated activities in the value chain, which results in high costs. Considering the fact that differentiation always leads to profitability is absolute nonsense. This results in loss to the organizations.

The disadvantages associated with differentiation should be looked upon with utmost care by the organizations going in for differentiation.

7.8 FOCUS

The third business level strategy is focus. Focus is different from other business strategies as it is segment based and has narrow competitive scope. This strategy involves the selection of a market segment, or group of segments, in the industry and meeting the needs of that preferred segment (or niche) better than the other market competitors. This is also known as a **niche** strategy. In focus strategy, the competitive advantage can be achieved by optimizing strategy for the target segments.

Focus strategy has two variants. They are:

- Cost Focus; and
- Differentiation Focus

Cost focus is where an organization seeks a cost advantage in the target segment; and

Differentiation focus is where an organization seeks differentiation in the target segment.

When we talk about focus strategy as a niche strategy, it means that a market niche is chosen where customers have distinct preferences or requirements. According to Thompson and Strickland the term '**niche**' is defined as "geographic uniqueness, by specialized requirements in using the product or by special product attributes that appeal only to niche members".

The success of the focus strategy depends on the difference of the target segment from other segments. To explain this concept, let us take example of soft drink market. Two major players in the Indian market are rivals but each has developed a competitive advantage by serving different segments offering flavoured drinks as well. The focuser can also have an above average level of performance by having an appropriate cost-focus and differentiation focus strategies.

Focus strategy can be effective in certain situations only they are:

- Market segment large enough to be profitable;
- Market segment has good growth potential;
- Market segment is not significant to the success of major competitors;
- Focuser has efficient resources;
- Focuser is able to defend against challenges;
- High costs are difficult to the competitors to meet the specialized needs of the niche;
- Focuser is able to choose from different segments.

There can be more situations depending on the need of the focuser. Focus/niche strategy has certain advantages as well as disadvantages or risks associated with it.

Advantages

Focus strategy, if implemented properly, has following advantages:

- Focuser can defend against Porters competitive forces;
- Focuser can reduce competition from new organizations by creating a niche of its own;
- Threat from producers producing substitute products is reduced;
- The bargaining power of the powerful customers is reduced;
- Focus strategy, if combined with low-cost and differentiation strategy, would increase market share and profitability.

Disadvantages

The disadvantages associated with focus strategy can be:

- Market segment may not be large enough to generate profits;
- Segment's need may become less distinct from the main market;
- Competition may take over the target-segment.

- We can very well say that the main objective of the focus/niche strategy is to perform a better job of serving buyers in the target market niche than rivals.

Activity 4

List one example each of automobile sector, technology sector, and airlines where the companies of respective sectors have adopted focus strategy.

1. Automobile

.....

2. Technology

.....

3. Airlines

.....

Let us now discuss the two variants of focus.

Cost Focus

This is basically a niche-low cost strategy whereby a cost advantage is achieved in focusers' target segment. According to Porter, cost focus exploits differences in cost behaviour in some segments. In this the focuser concentrates on a narrow buyer segment and out-competes rivals on the basis of lower cost.

Differentiation Focus

In this, the organization offers niche buyers something different from rivals. Here, the organization seeks differentiation in its target segment. Differentiation focus exploits the special needs of buyers in specified segments. A very good example of differentiation focus is the luxury car segment. After understanding all these business/generic strategies, we can say that if all the three are combined and the cost is optimized, then the market share and profitability can be increased. Focus strategy can be a tool to help the management team define and rebuild their business strategy, in turn helping them gain an edge over their competitors.

7.9 SUMMARY

The cost levels in Indian industry in general are high and this has an adverse effect on the demand of the products, both in the domestic and the international markets. A number of factors such as high government levies (excise, custom, and sales tax), uneconomic production levels and high manufacturing costs are responsible for this.

The role of cost depends upon the nature of the market, i.e., whether it is buyers' market or sellers' market. While cost is of critical importance to a producer operating in a buyers' market, it is relatively of little significance where s/he is operating in a sellers' market. The reason is that in the latter case s/he can pass on increase in cost to the buyers. As such s/he has no motivation to control or cut down costs.

This unit also discusses the concept of low cost competitive strategy known as cost leadership and how it helps the organizations to defend themselves against the five competitive forces. The three business/generic strategies, viz. overall cost leadership, differentiation and focus, play an important role in the success of a business. All the three strategies can be used individually or in combination to create a sustainable competitive advantage. Porter has specifically suggested that these strategies can be used to defend against the competitive forces.

An effort has been made to develop an understanding of differentiation and focus and how the two can be brought into practice. In differentiation, the organization tries to be unique in the industry whereas in focus, the organization tries to concentrate on a specific segment or a niche market. Overall, the unit tries to develop a practical approach towards understanding the business strategies.

7.10 KEYWORDS

Cost-leadership : is a low-cost competitive strategy.

Competitive advantage : It is about how an organization puts the business strategies into practice.

Differentiation : A strategy where an organization seeks to be unique in its industry along some dimensions that are widely valued by buyers.

Focus : A strategy which involves the selection of a market segment, or group of segments, in the industry and meeting the needs of that preferred segment (or niche) better than the other rivals.

7.11 SELF-ASSESSMENT QUESTIONS

- 1) Discuss the concept of cost leadership in the present context.
- 2) Explain the concept of differentiation strategy. Illustrate your answer with suitable examples.
- 3) Suppose you are the business strategist of your company, which is into manufacturing FMCGs. What would be your differentiation strategy looking at the present trends? Discuss.
- 4) Is focus strategy relevant in the present context? Discuss.

7.12 REFERENCES AND FURTHER READINGS

Bhattacharyya S.K. & N. Venkataraman (1983). *Managing Business Enterprises—Strategies, Structures and Systems*. New Delhi: Vikas Publishing.

Bolten, Neil & McManus, John. (1999). *Competitive Strategies for Service Organizations*. MacMillan Press Ltd.

Cherunilam, F. (2017). *Business Policy and Strategic Management—Text and Cases*. India: Himalaya Publishing House.

David, F. R. (2008). *Strategic Management: Concepts And Cases* (12th Ed.). India: Prentice-Hall Of India Pvt. Limited.

Kourdi, J. & Economist, T. (2015). *Business Strategy: A Guide to Effective Decision-Making*. United Kingdom: Public Affairs.

Kozami, A. (2002). *Business Policy and Strategic Management* (2nd ed.). India: McGraw-Hill Education (India) Pvt Limited.

Porter, M. E. (2008). *Competitive Advantage: Creating and Sustaining Superior Performance*. United Kingdom: Free Press.

Porter, M. E. (2008). *Competitive Strategy: Techniques for Analyzing Industries and Competitors*. United Kingdom: Free Press.

Rao, Subba P. (2004). *Business Policy and Strategic Management*. New Delhi: Himalaya Publishing House.

Sadler, P. (2004). *Strategic Management*. India: Kogan Page India Pvt. Ltd.



UNIT 8 COMPETITIVE STRATEGY

Objectives

After reading this unit you should be able to understand the:

- Process of formulating a competitive strategy;
- Concept of competitor analysis;
- Competitive moves made by the organization;
- Various dimensions of competitive strategy;
- Competitive strategies in different types of industries.

Structure

- 8.1 Introduction
- 8.2 Formulation of Competitive Strategy
- 8.3 Framework for Competitor Analysis
- 8.4 Competitive Moves
- 8.5 Dimensions of Competitive Strategy
- 8.6 Fragmented industries and Competitive Strategy
- 8.7 Emerging industries and Competitive Strategy
- 8.8 Declining industries and Competitive Strategy
- 8.9 Summary
- 8.10 Keywords
- 8.11 Self-Assessment Questions
- 8.12 References and Further Readings

8.1 INTRODUCTION

In unit 7 of block 2, we discussed business level strategy which consists of generic strategies. These three generic strategies viz Differentiation, Overall cost leadership and Focus form the basis of this unit. This unit is an extension of unit 7. In this unit we will learn different aspects of competitive strategy. After knowing all about generic competitive strategies, it is very important to understand how these strategies can be formulated. The organization need to understand how to tackle with the competitors and what specific decision to be taken while formulating a competitive strategy. There are various types of industries be it declining, fragmented or emerging. Each industry has to plan its own competitive strategy either to come out of a bad situation or to grow or expand. Michael E. Porter has described generic competitive strategies to cope with five competitive forces (unit 5). These strategies usually are consistent in nature that is why they are termed as generic strategies. These strategies help the organization in different situation to develop appropriate competitive strategy which can be implemented effectively.

8.2 FORMULATION OF COMPETITIVE STRATEGY

Any organization in any type of industry has a competitive strategy. This may be explicit or implicit in nature. If it is explicit then it is developed through a planning process taking into account the external environment and if it is implicit then it is developed through the activities of different functional units. In the present context the combination of the explicit and implicit strategies can be the best option as it gives the direction to the organization to achieve its set objectives.

Developing a competitive strategy is technically developing a formula for success. It should answer the following questions?

- What are the goals (ends) of the organization?
- What are the policies (means) to achieve these goals?

This is a classical approach to formulate a strategy but is still relevant in formulating any kind of strategy. Figure 8.1 depicts the “Wheel of Competitive Strategy” (Porter, 2008) which gives a broad view of an organization competitive strategy.



Figure 8.1: The Wheel of Competitive Strategy

Source: Adapted from Porter (2008)

The centre point depicts the goals of the organization which defines the way the business is going to compete including the economic and noneconomic objectives. The spokes of the wheel depict the functional areas through which the goals of

the organization can be achieved. Each spoke defines the key operating policies for a specific functional area. This wheel can be modified as per the needs of the organization. Therefore, the hub represents the goals and the spokes represent the policies.

Level of formulating competitive strategy

There are four key factors which determine the capability of the organization to successfully achieve these goals. Figure 8.2 depicts these factors.

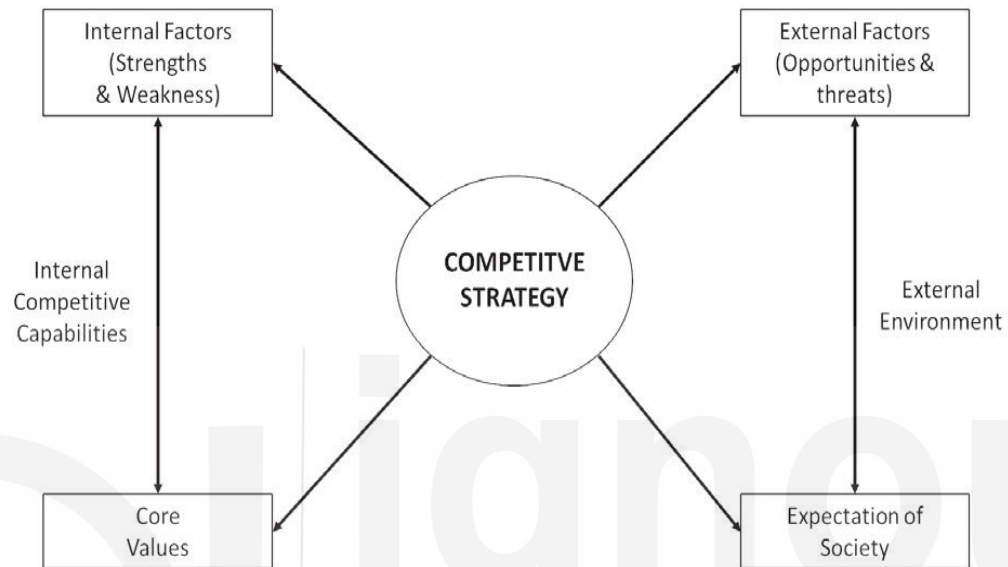


Figure 8.2: Factors determining the formulation of competitive strategy

An organization must take into consideration these four factors to develop realistic competitive strategy.

Consistency testing

It is necessary for an organization to test for consistency of the competitive strategy taking into consideration four important variables. These are

- Internal Consistency
- Environmental Fit
- Resource Fit
- Implementation

There are certain parameters which need to be checked for all the variables. These are as follows:

Internal Consistency

- Realistic goals;
- Key operating policies in sync/alignment with the goals;
- Key operating policies in sync with each other.

Environmental fit

- Capitalization of industry opportunities as per the goals and the policies;

- Goals and policies deal with the industry threats;
- Timing of the goals and policies with respect to the environmental changes;
- Goals and policies respond to societal expectation.

Resource fit

- Goals and policies match the available resources;
- Goals and policies adaptable to change.

Implementation

- Well designed goals which can be implemented;
- Alignment of goals and policies with that of the core values;
- Sufficient managerial capability for effective implementation.

The above considerations help in formulating an effective competitive strategy. The organization need to then follow the process of formulating a strategy.

Activity 1

Formulate a competitive strategy of a hypothetical organization using the four factors discussed in section 8.2.

8.3 FRAMEWORK FOR COMPETITOR ANALYSIS

We have learnt how a competitive strategy is formulated. After the formulation of the strategy the organization needs to position its business in such a manner that it maximizes its value proposition. Competitor analysis is one of the major components of strategy formulation. Therefore, it is important for organization to perform a competitor analysis.

There are four components which need to be covered in a competitor analysis. These are:

1. Future Goals
2. Current Strategy
3. Assumptions
4. Capabilities

An organization should analyze both the existing as well as the potential competitors. Figure 8.3 describes the components of a competitor analysis.

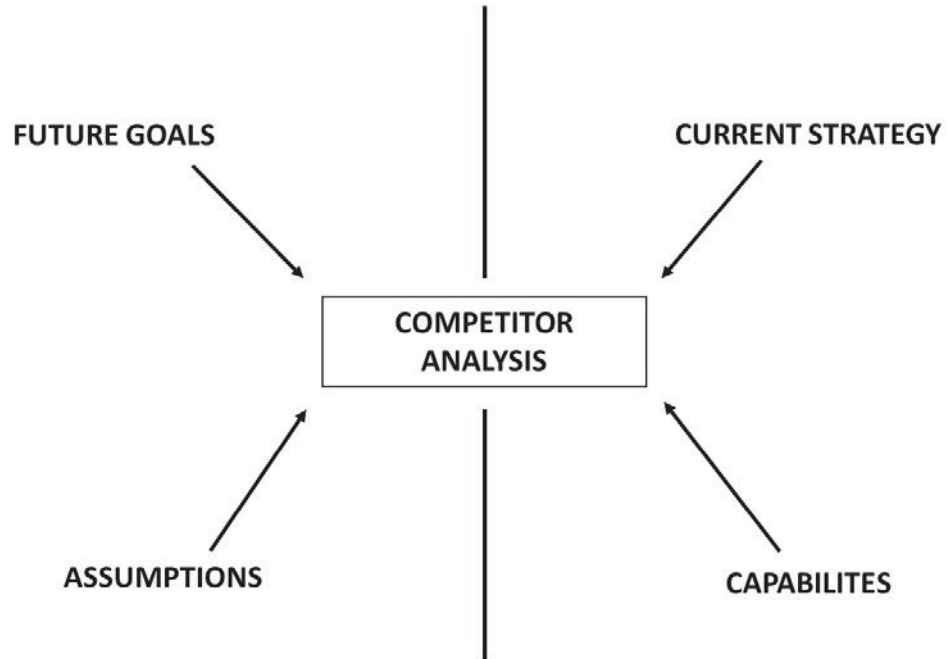


Figure 8.3: Components of a competitor Analysis

1. Future goals: It is very important to diagnose the goals of the competitors as it helps in:

- Predicting the current financial position of the organization;
- Predicting the strategic moves of the competitors if they are not satisfied with their present position;
- Predicting the reaction of the competitor to the external environment;
- Predicting reactions to strategic changes.

This can be understood with the help of an example. Suppose there are two organizations A and B. A is interested in maintaining stable sales growth being conservative in nature whereas B is interested in maintaining its rate of return on investment. Both the organizations will react differently to the situations like downturn in the business or increase in the market share.

In diagnosing the future goals of the competitors apart from the financial position, qualitative factors like targets with respect to market leadership, technological status, social status etc. is also important.

2. Assumptions: This is the second component in the competitor analysis and is quite critical in nature. There are two categories when the competitor's assumptions are identified.

- (a) Self-Assumption of the competitor;
- (b) Competitors' assumption about the industry and other organizations which are a part of the industry.

When we talk about self-assumptions then it means the set of assumptions in which an organization is operating. For e.g. the competitor may have an assumption that it is a market leader or an assumption that it is a socially conscious organization etc. These assumptions act as the

directing force for the organizations behaviour. It is not necessary that the assumptions made by the organization are accurate. This is where it loses the market share before it recognizes that there was flaw in its assumptions.

Similarly, the competitor's assumption about the industry also may not be accurate. Therefore, it is important to identify the biases, popularly known as blind spots so that the errors are minimized.

3. **Current Strategy:** The third component is assessing the current strategy of the competitors. This includes the policies in the functional areas. In competitor analysis it is necessary to assess both the internal and external strategies of the competitor.
4. **Capabilities:** This is the last component in the competitor analysis. This includes assessing the competitors' strengths and weaknesses which is done by using Porters five forces. The capabilities include the core competencies of the organization. The capabilities can be core or quick response capabilities, adaptability and sustainability.

Combining the four components, the competitors' position, as defensive or offensive, can be judged. This helps the organization to predict the moves to be made by the competitors.

Activity 2

Select an organization of your choice and perform a competitor analysis using the four components.

8.4 COMPETITIVE MOVES

As we have learnt that in competitor's analysis, the organization can predict whether the competitor is going to make offensive or defensive move. This is basically due to the instability in the industry. When we discuss competitive moves, this means that there are situations where the organizations compete against or with each other. Competitive moves can be classified as follows:

- a) Cooperative or non-threatening moves
- b) Threatening moves

Now let us discuss these in details

- a) **Cooperative or non-threatening moves:** As the name suggest, these are the moves which do not threaten the competitors. The categories of such type of moves are:

- Improving the position of the organization along with the position of the competitors even if they are not at par;

- Improving the position of the organization along with the position of the competitors only if a significant number match;
- Improving the position of the organization as the competitors are not able to match with them.

Moves are said to be nonthreatening when:

- Competitors are not aware of the adjustments made by the organization;
 - Competitors are not at all concerned due to their own assumptions;
 - Performance of the competitors is impaired due to their own assumptions.
- b) **Threatening moves:** There are certain moves which may threaten the competitors. The key to such type of move is predicting and influencing retaliation. Retaliation can be fast, or slow, effective or ineffective; tough or soft. Based on the kind of retaliation the move can be adjudged as highly threatening or it may be mild.

Non-Threatening moves can be termed as defensive competitor moves whereas threatening moves can be termed as offensive competitive moves.

Activity 3

Select an organization and study its strategy. Analyze whether the organization is going for offensive move or defensive move. Justify.

.....

.....

.....

.....

8.5 DIMENSIONS OF COMPETITIVE STRATEGY

Let us now discuss different dimensions of competitive strategy. Each organization has its own competitive strategy. However, the main dimensions are discussed below which demarcate an organizations competitive strategy from that of others. The various dimensions of competitive strategy are as follows:

- **Specialization:** As the name suggests, this focuses on the efforts of the organization in specializing in teams of product line, market segments and the niche markets.
- **Branding:** This dimension focuses on the brand identification of the products than on the competition. This can be done through promotional techniques adopted by the organization.
- **Push vs Pull:** This dimension focuses on the degree to which brand identification can be done. It may be selling directly to the customer or through other distribution channels e.g. online platforms. Push strategy involves pushing the product or brand to the target consumers whereas pull strategy is about attracting the interest of the consumers towards the product or brand.

- **Distribution channel:** Selecting an appropriate distribution channel is important. The organization needs to decide which channel it has to use. It can be company owned, retail outlets, online platforms, specialty outlets etc.
- **Quality of product:** It is very important for organization to focus on this aspect. Quality of product matters a lot and it depends on the type of raw material, specifications, features etc. for making a finished product.
- **Technological leadership:** It focuses on the degree to which an organization seeks leadership in the technology. These are organizations which tend to imitate the product and this is where they lack the competitive advantage.
- **Vertical integration:** This explains the degree to which the organization follows forward and backward integration.
- **Cost-position:** Optimum utilization of cost is very important for competitive advantage.
- **Service:** This gives the degree to which the organization provides ancillary services. This may be in the form of in-house service network, credit, after sales service etc.
- **Pricing policy:** This is one of the important dimensions as it describes the price position of the organization in the market. This is a distinct strategic variable and should be considered separately.
- **Leverage:** This is the financial as well as operating leverage of the organization.
- **Relationship of Strategic Business Unit (SBU) with the parent organization:** This is important as a SBU can be a part of a major conglomerate and its relationship with the parent organization will have an impact on the objectives, resources available etc. of the SBU.

The scope of strategic differences with respect to these dimensions depends on the nature of the industry. All the strategic dimensions are related. For e.g. an organization with a relatively low price has a low-cost position and may not have a superior product quality. The organization can become low-cost only if it has a high degree of vertical integration. This example shows that strategic dimensions for a specific organization form a consistent set internally.

8.6 FRAGMENTED INDUSTRIES AND COMPETITIVE STRATEGY

Fragmented industries comprises of organizations which do not have a significant market share but can influence the industry strongly. Fragmented industries consist of a large number of small and medium sized organizations. The industries make the environment unique in the sense that they do not have market leaders. These industries can range from services, retail, and agriculture to creative businesses. Some fragmented industries are characterized by differentiated products like

software, TV etc. and some undifferentiated products like fabricated aluminum. Designing a specific competitive strategy for a fragmented industry is a combination of the generic strategic management process along with the specific dimensions discussed here.

Probable strategic hindrances

There are many strategic traps which hinder the competitive position of the fragmented industry. Some of the common hindrances which need to be taken care of while formulating the competitive strategy are:

- **Aiming for dominance:** Aiming for dominance by a fragmented industry can be detrimental. If the organization tries to gain dominant share it leads to the failure of the organization.
- **Dearth of strategic discipline:** A high level of strategic discipline is a must for competing in fragmented industries. An opportunistic strategy may work in the short-run but a disciplined approach is a must to sustain and be successful in the long run.
- **Over centralization:** In many fragmented industries it is seen that they are controlled centrally. This can be counterproductive as the essence of competition in such industry is personalized service, local contact, controlled operations and the ability and adaptability to change to the environmental fluctuations.
- **False assumptions:** It has been seen that the organizations have false or inaccurate assumptions about the other organizations. Most of the organization has owners for the non-economic reasons like person from the family, so there are chances of errors in assessing the assumptions of other organizations. The faultiest assumption is that the competitors have same overheads and objectives.
- **Reaction to new products:** Usually the organizations in fragmented industry tend to overreact to new products. This results in the increase in costs and overheads leading to competitive disadvantage. This occurs because of large number of competitors insures that buyer is able to pay for a new product. Therefore coping with the new product becomes all the more difficult in fragmented industry.

These were the generic strategic traps. There can be more such traps depending on the type of industry. These traps need to be considered to formulate the strategy.

Formulating Competitive Strategy in Fragmented Industry

Collating the concept of fragmented industry and the strategic hindrances we can outline a broad framework to formulate a competitive strategy in fragmented industry. This is a broad framework which can be tweaked as per the requirement of the organization. There are five steps involved. These are:

Step 1: Conducting industry and competitor analysis

Step 2: Identifying the causes of fragmentation in industry

Step 3: Examining the causes of fragmentation**Step 4: Predicting the new structural equilibrium in the industry****Step 5: Coping with fragmentation**

All the four steps are interrelated. **Step 1** focuses on conducting industry analysis on the whole industry and also to perform the competitor analysis. This will help the organization to identify the sources of the competitive forces in the industry and the standing of the competitors in the industry.

Step 2 focuses on identifying the reasons which made the industry fragmented. It is important to have a list of all the reasons and assess their relationship with the economies of the industry.

Step 3 focuses on investigating the causes of industry fragmentation with respect to industry and competitor analysis. This will help the organization to assess whether these causes can be overcome say by innovation or strategic change.

Step 4 depends on the previous three steps. The organization needs to assess whether the fragmentation can be overcome or not and if it can be then whether the industry is able to give attractive returns or not. The organization needs to predict a new structural equilibrium.

Step 5 deals with coping the fragmentation in case the fragmentation is inevitable. In this step the organization needs to select the best alternative which can be used to cope with the fragmented structure.

Though this can be an ideal competitive strategy for fragmented industry but it can be applicable to overcome the fragmentation and develop competitive advantage.

8.7 EMERGING INDUSTRIES AND COMPETITIVE STRATEGY

As the name suggests, emerging industries are the industries which are new or are re-formed due to emergence of socio-economic developments. The best example can be from the present pandemic situation which has given rise to new organizations which are catering to the specific customer needs. This situation has also given rise to the existing organizations modifying themselves and emerging in new avatars to cater to the end users. Industries like Solar power, wind power, online gaming, OTT platforms, social media platforms etc. are a result of potentially viable opportunities for businesses. The main feature of such industry is that there are no specific rules of the game. The absence of rules can be both risky as well as opportunistic. However in both the cases they need to be managed. The major competitive problems in the industry are establishing a set of rules so that the organization can cope with it and be successful.

Features of Structural Environment

Each industry may have its own structure but here are some common factors which identify the industry in their emerging stage of development. There are certain features of the structural environment in the emerging industry. Figure 8.4 depicts these:



Figure 8.4: Elements of Structural Environment in Emerging Industries

Uncertain technological environment: In an emerging industry there is lot of technological uncertainty. Uncertainty can be in terms of the configuration of the product, production technology etc. For e.g. in manufacturing optical fibers, there are number of different processes available and are being used by different organization in the industry. Which one will be or is the best cannot be predicted unless the product is accepted in the market.

Uncertain strategy: There are number of strategic approaches tried by the participants in the industry. There is no 'right' strategy creating level of uncertainty. Every organization tries different approaches of strategy. For e.g. organization manufacturing solar heating panels use different approaches with respect to supply chain, market segmentation etc. as the organizations are not much aware of the competitors, customer perception and industry conditions in the emerging phase.

High Volatility: It is a known fact that small volumes of production result in high costs especially in the emerging industries. In this case the learning curve is very steep especially with new technology. Initially the steep learning curve results in high costs but as the productivity increases these costs decline at a very high proportional rate. The decline in cost is even more if the learning is combined with increasing opportunities. This situation results in an unbalanced situation.

Nascent Organizations and Spin-offs: As discussed earlier, the emerging phase has more proportion of newly formed organizations. The Nascent organization is in a position to enter the emerging industry as neither there is set rules nor economies of scale acting as a deterrent. Usually this happens with the organization into digital equipments.

Apart from the nascent organization these are spin-off organizations as well. Majority of these are the organizations created by employees by leaving their parent organization. Spin-offs occur due to perceived opportunity, rewards of equity participation, fluid technology and strategy and creativity.

First time buyers: Usually in the emerging industry, the buyers of the product are first-time buyers. The organizations try to use specific marketing tactics to influence the buyers to buy new products. For e.g. the organizations manufacturing solar heating panels try to convince the homeowners and homebuyers convincing about the sustainability of the product.

Shorter Time Period: The time period to take the end product to reach to the customers to meet the demand is very short. This makes the organization to act fast using conventional wisdom.

Subsidy: There may be subsidies in many emerging industries especially those are coming up with new technology or addressing the societal concerns. Solar heating panels are a very good example where the subsidy is being provided by government and also the start-ups with innovative and indigenous ideas are being given subsidy. From the strategic point of view subsidies may cause instability to the industries.

Formulating competitive strategy

Now we know the structural environment of emerging industries. It is important for organizations to cope with the uncertainty and risk associated with the environment. This can be done by making certain strategic choices. The positive aspect of uncertainty is that there is more freedom to make good strategic choices.

The following strategic choices can be made to formulate the competitive strategy.

- **Shaping Industry Structure:** The organization can give a shape to the industry structure by setting the rules of the game. This can be done by making appropriate strategic choices. It can be done in the areas of pricing, marketing etc.
- **Externalities:** A major strategic issue in the industry is the dependence on the external environment. The organization needs to strike a balance between the industry advocacies at the same time pursuing its own interests. Therefore, the organization should promote standardization, police substandard quality and attract first time buyers.
- **Changing role of supply Chain:** The organizations should be ready for a probable shift in the orientation of its suppliers and distribution channels. Since the supply chain is dependent on the industry conditions, the organization should adapt to the changing conditions. For e.g. distribution channels may become more proactive to invest in advertising etc. If the organization is ready to change then it can exploit such opportunities to give itself a strategic leverage.
- **Shift of Mobility Barriers:** The common barriers in emerging technology can be
 1. Proprietary technology
 2. Access to raw materials and distribution channel
 3. Cost advantage due to experience curve
 4. Risk

The organization should be prepared to defend itself and try to avoid these barriers. This will involve high level of commitment of capital. The organization should be prepared against integration and secure supplies and markets.

- **Entry Timing:** The timing to enter the emerging industry should be appropriate. Early entry involves risk but can have low entry barriers and can give higher returns.
- **Tactical Moves:** The organization planning to enter the emerging industry should make some tactical moves. These can be committing the suppliers of raw material and early financing can help lower the cost of capital.

In the merging industry the organizations tend to grow rapidly and gain profits but the decision for the organization to enter the industry should be based on proper structural analysis.

Activity 4

Select a start-up in the emerging industry of your choice and try to formulate a competitive strategy for the same.

.....

.....

.....

.....

8.8 DECLINING INDUSTRIES AND COMPETITIVE STRATEGY

Declining industries are those which have experienced complete decline in unit sales for a considerable period of time. Declining situation is a real time situation for which an end game strategy needs to be developed. Decline may be due to many reasons. Some of them are listed below:

- Low economic growth
- Rapid cost inflation
- Rapid technological advancements

Declining industry is characterized by low or declining markets, trimming product line, lack of R&D and no promotional policy leading to reducing competitors. The accepted role for formulating a strategy, for declining industry is the harvest strategy which focuses on putting an end to the investment, trying to generate maximum cash flow from the business and then going for divestment; figure 8.5 depicts a model for harvest strategy.

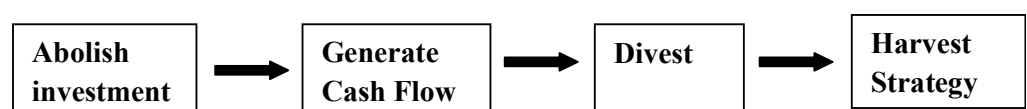


Figure 8.5: Model for Harvest Strategy

However, when the nature of competition is studied in declining industry, it is quite complex as the industries differ in which they respond. Some industries

exit gracefully and some enter into complexities. It is therefore, important to understand the structured environment of declining industry. This can be done by understanding the determinants of competition in decline phase.

Determinants of competition in decline phase:

The determinants which have a major impact on the declining industry can be generalized as follows:

- Uncertainty
 - Declining pattern
 - Pockets of demand
 - Reasons for decline
 - Exit barriers
 - Rivals/ volatility
- **Uncertainty:** This is one of the major factors which affect the end game competition. It determines the degree of uncertainty which is perceived by the competitors about the demand that whether demand will continue to decline or not. Organizations may differ in their perceptions regarding future demand. Some may visualize that the demand will increase and such organizations tend to continue. Some organization may not think so and may take the decision to exit. The stronger is the organization's position and higher the exit barriers, the future positioning of the organization seems to be quite optimistic.
 - **Declining pattern:** The pattern of decline whether it is steady, slow or high depicts the volatility of this phase. The rate of decline determines the withdrawal capacity of the organization.
 - **Demand pockets:** The demand pockets are the areas where the demand still exists in declining industry. The demand pockets play an important role in determining the profitability of the competitors who are left in the business.
 - **Reasons for decline:** There can be many reasons for decline and they have an impact on competition during the decline phase. These factors can be substituting technology, demographics, shifts in customer perception etc. The reasons for decline provide a clue for the probable degree of uncertainty organizations perceive about the future demand.
 - **Exit barriers:** The capacity in which the organization leaves is quite crucial to competition in declining industries. The exit barriers force the organizations to keep competing in the declining industry. The higher the exit barrier, higher is the inhospitability in the industry.
 - **Rivals' volatility:** As the sales decline, there can be a situation of price warfare among the competitors. This price war arises because the product is perceived as commodity, fixed costs tend to rise, and organizations get stuck due to exit barriers and uncertainty.

The determinants discussed above give an idea regarding the position of the competitors in the decline phase. Keeping these determinants into consideration, strategic alternatives in decline phase are discussed below:

Usually strategy during decline revolves around harvest strategy but there can be other probable alternatives though it are not necessary that all the alternatives are viable. There can be four basic approaches to develop a competitive strategy in decline. These are:

- Leadership strategy
- Niche strategy
- Harvest strategy
- Quick divestment strategy

Table 8.1 gives the description of these strategies.

Table 8.1 Alternative Strategies in Decline

S. No.	Basis of Comparison	Leadership	Niche	Harvest	Quick Divestment
1.	Nature	Leader in terms of market share	Defend or create strong position in specific segment	Taking advantage of strengths, manage controlled disinvestment	Liquidate investment
2.	Investment	Aggressive	Moderate	Abolish	Liquidate quickly
3.	Market position	Strong	Strong	Weak	Weak
4.	Demand position	High	Stable	Past strengths cashed	Buyer in bargaining position
5.	Impact of exit barriers	Low	Low	High	High

Strategic choice in decline

Choosing a right strategy in declining industry depends on the requirement of the organization with the relative position of the organization. Organizations situated differently will have different optimal strategies in decline phase. Figure 8.6 shows the matrix of the strategic alternatives available to the organization.

Leadership or Niche: This alternative is available when the industry structure is favourable to hospitable decline phase. This is the result of low uncertainty, less exit barriers etc.

Niche or Harvest: This strategic alternative is available when the industry is not favourable to decline. This may be due to high exit barriers for competitors leading to volatile end-game rivalry.

Harvest or Quick Divestment: This strategic position arises due to organizations need to remain in the business. In this case the organization should assess its strategic needs and match with the industry structure to determine appropriate strategy.

To conclude we can say that it is important for organization to performs a thorough internal analysis and then match it with external analysis and try to improve its position in the decline phase.

		INTERNAL CAPABILITIES & MARKET POSITION	
		Strong	Weak
INDUSTRY ENVIRONMENT	Hospitable decline phase	Leadership or Niche	Harvest or Quick Divestment
	Inhospitable decline phase	Niche or Harvest	Quick Divestment

Figure 8.6: Strategic Alternatives in Decline

8.9 SUMMARY

Competition has always been the focal point of every organization. Each organization whether it is an old organization or a new one or a start-up has a one point agenda and that is how to be successful. In unit 5 of block 2 we have discussed the three generic competitive strategies viz-a-viz overall cost leadership, differentiation and focus. These three strategies build a background for framing the competitive strategy for an organization. In this unit we discuss the formulation part of competitive strategy and how to perform a competitor analysis. The wheel of competitive strategy gives an idea to the classical approach to strategy. It is important to note here is that competitive strategy is different for different organizations. This is the reason we have discussed the competitive strategy in different types of industries. Although the basic strategy formulation remains the same but keeping in view certain dimensions of competitive strategy in different industries, specific competitive strategy can be formulated. The unit as a whole discusses various aspects of the formulation of competitive strategy.

8.10 KEYWORDS

- Competitive strategy** : It is the long term plan of action of the organization to gain competitive advantage.
- Competitor analysis** : It is the process of assessing the strengths and the weaknesses of competitors.

- Fragmented Industry** : It is an industry in which the organizations do not have a significant market share to become market leaders.
- Emerging Industry** : This is a newly formed or re-formed industry created as a result of social or economic changes.
- Declining Industry** : This is the industry which has declined in terms of sales for a long period.

8.11 SELF-ASSESSMENT QUESTIONS

- 1) What is competitive strategy? Discuss with illustrations.
- 2) How is a competitive strategy formulated?
- 3) Explain the concept of competitor analysis.
- 4) What are the different dimensions which need to be considered while formulating a competitive strategy?
- 5) How can you formulate a competitive strategy for;
 - a) Fragmented Industry
 - b) Emerging Industry
 - c) Declining Industry

8.12 REFERENCES AND FURTHER READINGS

Bensoussan, B. E. & Fleisher, C. S. (2015). *Business and Competitive Analysis: Effective Application of New and Classic Methods*. United States: Pearson Education.

Charan, R. (2021). *Rethinking Competitive Advantage: New Rules for the Digital Age*. United Kingdom: Random House.

Daidj, N. (2014). *Developing Strategic Business Models and Competitive Advantage in the Digital Sector*. United States: IGI Global.

Flanagan, W. G. & Smith, J. L. (2006). *Creating Competitive Advantage: Give Customers a Reason to Choose You Over Your Competitors*. United Kingdom: Currency/Doubleday.

Porter, M. E. (2008). *Competitive Advantage: Creating and Sustaining Superior Performance*. United Kingdom: Free Press.

Porter, M. E. (2008). *Competitive Strategy: Techniques for Analyzing Industries and Competitors*. United Kingdom: Free Press.

Wright, S. (2014). *Competitive Intelligence, Analysis and Strategy: Creating Organizational Agility*. (n.p.): Taylor & Francis.

UNIT 9 CORPORATE LEVEL STRATEGY

Objectives

After reading this unit, you should be able to:

- Acquaint yourself with the concept of corporate strategy;
- Familiarize yourself with the various generic corporate strategies;
- Explain the nature, scope and approaches to implementation of stability and growth strategies; and
- Understand different diversification strategies;
- Learn the concept of retrenchment strategy; and
- Understand the concept of turnaround strategy.

Structure

- 9.1 Introduction
- 9.2 Nature and Scope of Corporate Strategies
- 9.3 Types of Corporate Strategies
- 9.4 Stability Strategy
- 9.5 Expansion Strategies
- 9.6 Diversification
- 9.7 Alternative Routes to Diversification
- 9.8 Retrenchment Strategies
- 9.9 Summary
- 9.10 Key Words
- 9.11 Self-Assessment Questions
- 9.12 References and Further Readings

9.1 INTRODUCTION

Strategic management deals with the issues, concepts, theories approaches and action choices related to an organization's interaction with the external environment. It in general, refers to how a given objective will be achieved. Strategy, therefore, is mainly concerned with the relationships between ends and means, that is, between the results we seek and the resources at our disposal. Some organizations are groups of different business and functional units, each of them must be having its own set of goals, which may not necessarily be same as the goals of the corporate headquarters looking after the interests of the entire organization.

Since the goals are different and the means to achieve them are different, strategies are likely to be different. As per Porter this understanding has led to the hierarchical

division of strategy at two levels: a **business-level (competitive) strategy and an organization-wide strategy (corporate strategy)**. In addition to these strategies, many authors also mention functional strategies, practiced by the functional units of a business unit, as another level of strategy.

Corporate Strategies are concerned with the broad, long-term questions of “what businesses are we in, and what do we want to do with these businesses?” The corporate strategy sets the overall direction the organization will follow. **Competitive Strategies** involves the decisions that determine how the organization will compete in a specific business or industry. This involves deciding how the organization will compete within each line of business or strategic business unit (SBU). Competitive strategies include being a low-cost leader, differentiator, or focuser. **Functional Strategies** are also called operational strategies, are the short-term (less than one year), goal-directed decisions and actions of the organization’s various functional departments. Functional strategies identify the basic course of action that each functional department in a strategic business unit will pursue to contribute to the attainment of its goals.

In a nutshell, corporate-level strategy identifies the portfolio of businesses that in total will comprise the corporation and the ways in which these businesses will relate. The competitive strategy identifies how to build and strengthen the business’s long-term competitive position in the marketplace while the functional strategies identify the basic courses of action that each department will pursue to contribute to the attainment of its goals.

Corporate Strategy

Corporate strategy is essentially a blueprint for the growth of the organization. It sets the overall direction for the organization to follow. It also spells out the extent, pace and timing of the organization’s growth. Corporate strategy is mainly concerned with the choice of businesses, products and markets. Defined formally, a corporate-level strategy is an action taken to gain a competitive advantage through the selection and management of a mix of businesses competing in several industries or product markets. Corporate strategies are normally expected to help the organization earn above-average returns and create value for the shareholders and address the issues of a multi-business organization as a whole. It deals with the following questions:

- What should be the nature and values of the organization in the broadest sense?
- What are the aims in terms of creating value for stakeholders?
- What kind of businesses should the organization be in?
- What should be the scope of activity?
- Whether divestment is required?
- Whether expansion is required?
- What structure, systems and processes will be necessary to link the various businesses to each other and to the corporate centre?
- How can the corporate centre add value to make the whole worth more than the sum of the parts?

Most corporate level strategies have three major components:

- a) **Growth or directional strategy** which outlines the growth objectives ranging from drastic retrenchment through stability to varying degrees of growth and methods and approaches to accomplish these objectives.
- b) **Portfolio strategy** helps corporations for creating value through their businesses. Portfolio strategy plans the necessary moves to establish positions in different businesses and achieve an appropriate amount and kind of diversification. A portfolio strategy is concerned not only about choice of business portfolio, but also about portfolio of geographical markets for acquisition of inputs, locating various value chain activities and selling of outputs. In short, a portfolio strategy facilitates efficient allocation of corporate resources, links the businesses and geographically dispersed activities and builds synergy leading to corporate or parenting advantage.
- c) **Corporate parenting strategy**, which tries to capture valuable cross-business strategic fits in a portfolio of business and turn them into competitive advantages, especially transferring and sharing related technology, procurement leverage, operating facilities, distribution channels, and/or customers. In other words, it decides how organizations allocate resources and manage the capabilities and activities across the portfolio. Corporate parenting views the corporation in terms of resources and capabilities that can be used to build business units value as well as generate synergies across business units. Corporate parenting generates corporate strategy by focusing on the core competencies of the parent corporation and on the value create from the relationship between the parent and its businesses.

9.2 NATURE AND SCOPE OF CORPORATE STRATEGIES

Growth is essential for an organization. Organizations go through an inevitable progression from growth through maturity, revival, and eventually decline. The broad corporate strategy alternatives, sometimes referred to as grand strategies, are: stability/consolidation, expansion/growth and divestment/retrenchment and combination strategies. During the organizational life cycle, managements choose between growth, stability, or retrenchment strategies to overcome deteriorating trends in performance.

At the core of corporate strategy must be a clear logic of how the corporate objectives, will be achieved. Most of the strategic choices of successful corporations have a central economic logic that serves as the fulcrum for profit creation. Some of the major economic reasons for choosing a particular type of corporate strategy are:

- Exploiting operational economies and financial economies of scope;
- Avoiding uncertainty and increasing efficiency;
- Management skills creating corporate advantage;.
- Long term profit potential of a business.

The non-economic reasons for the choice of corporate strategy elements include:

- Dominant view of the top management;
- Employee incentives to diversify (maximizing management compensation);
- Desire for more power and management control;
- Ethical considerations ;
- Corporate Social Responsibility.

9.3 TYPES OF CORPORATE STRATEGIES

Corporate level strategies are also termed as grand strategies. There are four types of generic corporate strategies. They are:

- **Stability strategies:** make no change to the organization's current activities
- **Growth strategies:** expand the organization's activities
- **Retrenchment strategies:** reduce the organization's level of activities
- **Combination strategies:** a combination of above strategies

Let us discuss each strategy on by one.

Stability Strategy

Stability strategy is a strategy in which the organization retains its present strategy at the corporate level and continues focusing on its present products and markets. The organization stays with its current business and product markets; maintains the existing level of effort; and is satisfied with incremental growth. It does not seek to invest in new factories and capital assets, gain market share, or invade new geographical territories. Organizations choose this strategy when the industry in which it operates or the state of the economy is in turmoil or when the industry faces slow or no growth prospects. They also choose this strategy when they go through a period of rapid expansion and need to consolidate their operations before going for another phase of expansion.

Growth Strategy

Organizations choose expansion strategy when their perceptions of resource availability and past financial performance are both high. The most common growth strategies are diversification at the corporate level and concentration at the business level. Diversification is defined as the entry of an organization into new lines of activity, through internal or external modes. The primary reason an organization pursues increased diversification are value creation through economies of scale and scope, or market dominance. In some cases organizations choose diversification because of government policy, performance problems and uncertainty about future cash flow. In one sense, diversification is a risk management tool. Risk plays a very vital role in selecting a strategy and hence, continuous evaluation of risk is linked with an organization's ability to achieve strategic advantage. Internal development can take the form of investments in new products, services, customer segments, or geographic markets including

international expansion. Diversification is accomplished through external modes through acquisitions and joint ventures. Concentration can be achieved through vertical or horizontal growth. Vertical growth occurs when an organization takes over a function previously provided by a supplier or a distributor. Horizontal growth occurs when the organization expands products into new geographic areas or increases the range of products and services in current markets.

Retrenchment Strategy

Many organizations experience deteriorating financial performance resulting from market erosion and wrong decisions by management. Managers respond by selecting corporate strategies that redirect their attempt to turnaround the organization by improving their organization's competitive position or divest or wind up the business if a turnaround is not possible. Turnaround strategy is a form of retrenchment strategy, which focuses on operational improvement when the state of decline is not severe. Other possible corporate level strategic responses to decline include growth and stability.

Combination Strategy

The three generic corporate strategies can be used in combination; they can be sequenced, for instance growth followed by stability, or pursued simultaneously in different parts of the business unit. Combination Strategy is designed to mix growth, retrenchment, and stability strategies and apply them across a corporation's business units. An organization adopting the combination strategy may apply the combination either simultaneously (across the different businesses) or sequentially.

Activity 1

Search the internet for information on three different groups of organizations. Compare the business models of each one of them and briefly explain the type of corporate strategies that these follow.

.....

.....

.....

.....

.....

9.4 STABILITY STRATEGY

An organization following stability strategy maintains its current business and product portfolios; maintains the existing level of effort; and is satisfied with incremental growth. It focuses on fine-tuning its business operations and improves functional efficiencies through better deployment of resources. In other words, an organization is said to follow stability/ consolidation strategy if:

- It decides to serve the same markets with the same products;
- It continues to pursue the same objectives with a strategic thrust on incremental improvement of functional performances; and

- It concentrates its resources in a narrow product-market sphere for developing a meaningful competitive advantage.

Adopting a stability strategy does not mean that an organization lacks concern for business growth. It only means that their growth targets are modest and that they wish to maintain a status quo. Stability strategy is basically a defensive strategy as products, markets and functions remain unchanged. A stability strategy is ideal in stable business environments where an organization can devote its efforts to improving its efficiency while not being threatened with external change. In some cases, organizations are constrained by regulations or the expectations of key stakeholders and hence they have no option except to follow stability strategy.

Generally large organizations with a sizeable portfolio of businesses do not usually depend on the stability strategy as a main route, though they may use it under certain special circumstances. They normally use it in combination with the other generic strategies, adopting stability for some businesses while pursuing expansion for the others.

However, small organizations find this a very useful approach since they can reduce their risk and defend their positions by adopting this strategy. Niche players also prefer this strategy for the same reasons.

Conditions Favouring Stability Strategy

Stability strategy does entail changing the way the business is run, however, the range of products offered and the markets served remain unchanged or narrowly focused.

An organization's strategists might choose stability when:

- The industry or the economy is in turmoil or the environment is volatile.
- Uncertain conditions;
- Environmental turbulence is minimal and the organization does not foresee any major threat to itself and the industry concerned as a whole;
- The organization just finished a period of rapid growth and needs to consolidate its gains before pursuing more growth;
- The organization's growth ambitions are very modest and it is content with incremental growth;
- The industry is in a mature stage with few or no growth prospects and the organization is currently in a comfortable position in the industry.

Managers pursue stability strategy when they feel that the organization has been performing well and wish to maintain the same trend in subsequent years. They would prefer to adopt the existing product-market posture and avoid departing from it. Sometimes, the management is content with the status quo because the organization enjoys a distinct competitive advantage and hence does not perceive an immediate threat.

Stability strategy is also adopted in a number of organizations because the management is not interested in taking risks by venturing into unknown terrain.

In fact they do not consider any other option as long as the pursuit of existing business activity produces the desired results. Conservative managers believe product development, market development or new ways of doing business entail great risk and therefore, avoid taking decisions, which can endanger the organization.

Approaches to Stability Strategy

There are various approaches to developing stability/consolidation strategy. The Management has to select the one that best suits the corporate objective. Some of these approaches are discussed below. In all these approaches, the fundamental course of action remains the same, but the circumstances in which the organizations choose various options differ.

Holding Strategy: This alternative may be appropriate in two situations: (a) the need for an opportunity to rest, digest, and consolidate after growth or some turbulent events - before continuing a growth strategy, or (b) an uncertain or hostile environment in which it is prudent to stay in a “holding pattern” until there is change in or more clarity about the future in the environment. With a holding strategy the organization continues at its present rate of development. This approach suits an organization, which does not have requisite resources to pursue increased growth for a longer period of time. At times, environmental changes prohibit a continuation in growth.

Stable Growth: This alternative essentially involves avoiding change, representing indecision or timidity in making a choice for change. Alternatively, it may be a comfortable, even long-term strategy in a mature, rather stable environment, e.g., a small business in a small town with few competitors. It grows slowly but surely, increasingly its market penetration by steadily adding new products or services and carefully expanding its market.

Harvesting Strategy: In this approach, an organization has a dominant market share and seeks to take advantage of this position thereby generating cash for future business expansion. This approach is most suitable to an organization whose main objective is to generate cash. Even market share may be sacrificed to earn profits and generate funds. A number of ways can be used to accomplish the objective of making profits and generating funds. Some of these are selective price increases and reducing costs without reducing price.

Profit or Endgame Strategy: A profit strategy is one that capitalizes on a situation in which old and obsolete product or technology is being replaced by a new one. This type of strategy does not require new investment, so it is not a growth strategy. Organizations adopting this strategy decide to follow the same technology, at least partially, while transiting into new technological domains. Strategists in these organizations reason that the huge number of product based on older technologies on the market would create an aftermarket for spare parts that would last for years.

Activity 2

Identify few Indian organizations following stability strategy. Also identify the type of stability strategy followed by these organizations.

9.5 EXPANSION STRATEGIES

Every organization seeks growth as its long-term goal to avoid annihilation in a relentless and ruthless competitive environment. Growth offers ample opportunities to everyone in the organization and is crucial for the survival of the organization. However, this is possible only when fundamental conditions of expansion have been met.

Expansion strategies are designed to allow organizations to maintain their competitive position in rapidly growing national and international markets. Hence to successfully compete, survive and flourish, an organization has to pursue an expansion strategy. Expansion strategy provides a blueprint for business organizations to achieve their long-term growth objectives. It allows them to maintain their competitive advantage even in the advanced stages of product and market evolution.

Conditions for Opting for Expansion Strategy

Organizations opt for expansion strategy under the following circumstances:

- Organization having high growth objectives;
- New opportunities in the environment;
- Market leader trying to continue being a market leader;
- Volatile situations;
- Surplus resources;
- Regulatory environment.

Growth of a business organization entails realignment of its strategies in product – market environment. This is achieved through the basic growth approaches of intensive expansion, integration (horizontal and vertical integration), diversification and international operations.

Expansion through intensification

Intensification involves expansion within the existing line of business. Intensive expansion strategy involves safeguarding the present position and expanding in the current product-market space to achieve growth targets. Such an approach is very useful for organizations that have not fully exploited the opportunities existing in their current products-market domain. An organization selecting an intensification strategy concentrates on its primary line of business and looks for ways to meet its growth objectives by increasing its size of operations in its primary business. Intensive expansion of an organization can be accomplished in three ways, namely, market penetration, market development and product

development. Intensification strategy is followed when adequate growth opportunities exist in the organization's current products-market space. However, while going in for internal expansion, the management should consider the following factors.

- While there are a number of expansion options, the one with the highest net present value should be the first choice.
- Competitive behaviour should be predicted in order to determine how and when the competitors would respond to the organization's actions. The organization must also assess its strengths and weaknesses against its competitors to ascertain its competitive advantages.
- The conditions prevailing in the environment should be carefully examined to determine the demand for the product and the price customers are willing to pay.
- The organization must have adequate financial, technological and managerial capabilities to expand the way it chooses.
- Technological, social and demographic trends should be carefully monitored before implementing product or market development strategies. This is very crucial, especially, in a volatile business environment.

Ansoff's Product-Market Expansion Grid

The product/market grid first presented by Igor Ansoff (1968), shown in exhibit 1, has proven to be very useful in discovering growth opportunities. This grid best illustrates the various intensification options available to an organization. The product/market grid has two dimensions, namely, products and markets. Combinations of these two dimensions result in four growth strategies. According to Ansoff's Grid, three distinct strategies are possible for achieving growth through the intensification route. These are:

- **Market Penetration:** The organization seeks to achieve growth with existing products in their current market segments, aiming to increase its markets share.
- **Market Development:** The organization seeks growth by targeting its existing products to new market segments.
- **Product Development:** The organization develops new products targeted to its existing market segments.
- **Diversification:** The organization grows by diversifying into new businesses by developing new products for new markets.

Exhibit 1: Ansoff's Grid

MARKETS/ PRODUCTS	Current Markets	New Markets
Current Products	Market Penetration	Market Development
New Products	Product Development	Diversification

Combination Strategy

Combination strategy combines the intensification strategy variants i.e. market penetration, market development and product development to grow. In the market development and market penetration strategy, the organization continues with its current product portfolio, while the product development strategy involves developing new or improved products, which will satisfy the current markets.

Activity 3

Search for information about an organization following intensification strategies. Why is the organization following these strategies? Discuss.

.....

.....

.....

.....

.....

.....

.....

Expansion through integration

In contrast to the intensive growth, integration strategy involves expanding externally by combining with other organizations. Combination involves association and integration among different organizations and is essentially driven by need for survival and also for growth by building synergies. Combination of organizations may take the merger or consolidation route. Merger implies a combination of two or more concerns into one final entity. The merged concerns go out of existence and their assets and liabilities are taken over by the acquiring organization. A consolidation is a combination of two or more business units to form an entirely new organization. All the original business entities cease to exist after the combination. Organizations use integration to:

- increase market share;
- avoid the costs of developing new products internally and bringing them to the market;
- reduce the risk of entering new business;
- speed up the process of entering the market;
- become more diversified and
- reduce the intensity of competition by taking over the competitor's business.

The costs of integration include reduced flexibility as the organization is locked into specific products and technology, financial costs of acquiring another organization and difficulties in integrating various operations. There are many forms of integration, but the two major ones are vertical and horizontal integration.

Vertical Integration: Vertical integration refers to the integration of organizations involved in different stages of the supply chain. Thus, a vertically integrated organization has units operating in different stages of supply chain starting from raw material to delivery of final product to the end customer. An organization tries to gain control of its inputs (called backwards integration) or its outputs (called forward integration) or both. Vertical integration may take the form of backward or forward integration or both. Some organizations expand vertically backwards and forward. In essence, an organization seeks to grow through vertical integration by taking control of the business operations at various stages of the supply chain to gain advantage over its rivals.

Factors conducive for vertical integration include

- Taxes and regulations on market transactions;
- Obstacles to the formulation and monitoring of contracts;
- Similarity between the vertically-related activities;
- Sufficient large production quantities so that the organization can benefit from economies of scale and
- Reluctance of other organizations to make investments specific to the transaction.

There are alternatives to vertical integration that may provide some of the same benefits with fewer drawbacks. The following are a few of these alternatives for relationships between vertically related organizations.

- Long-term explicit contracts
- Franchise agreements
- Joint ventures
- Co-location of facilities
- Implicit contracts (relying on organization's reputation)

Horizontal Combination / Integration: The acquisition of additional business in the same line of business or at the same level of the value chain (combining with competitors) is referred to as horizontal integration. Horizontal growth can be achieved by internal expansion or by external expansion through mergers and acquisitions of organizations offering similar products and services. An organization may diversify by growing horizontally into unrelated business. This sort of integration is sought to reduce intensity of competition and also to build synergies.

Benefits of Horizontal Integration

The following are some benefits of horizontal integration:

- Economies of scale-achieved by selling more of the same product, for example, by geographic expansion.
- Economies of scope – achieved by sharing resources common to different products. Commonly referred to as 'synergies'.

- Increased bargaining power over suppliers and downstream channel members.
- Reduction in the cost of global operations made possible by operating plants in foreign markets.
- Synergy achieved by using the same brand name to promote multiple products.

Disadvantages of Horizontal Integration

Horizontal integration by acquisition of a competitor will increase an organization's market share. However, if the industry concentration increases significantly then anti-trust issues may arise. Aside from legal issues, another concern is whether the anticipated economic gains will materialize. Before expanding the scope of the organization through horizontal integration, management should be sure that the imagined benefits are real. Many blunders have been made by organizations that broadened their horizontal scope to achieve synergies that did not exist, for example, computer hardware manufacturers who entered the software business on the premise that there were synergies between hardware and software. However, a connection between two products does not necessarily imply realizable economies of scope. Finally, even when the potential benefits of horizontal integration exist, they do not materialize spontaneously. There must be an explicit horizontal strategy in place. Such strategies generally do not arise from the bottom –up, but rather, must be formulated by corporate management.

9.6 DIVERSIFICATION

Diversification involves moving into new lines of business. When an industry consolidates and becomes mature, most of the organizations in that industry would reach the limits of growth using vertical and horizontal growth strategies. If they want to continue growing any further the only option available to them is diversification by expanding their operations into a different industry. Diversification strategies also apply to the more general case of spreading market risks; adding products to the existing lines of business can be viewed as analogous to an investor who invests in multiple stocks to “spread the risks”. Diversification into other lines of business can especially make sense when the organization faces uncertain conditions in its core product-market domain.

Diversification of an organization can take the form of concentric and conglomerate diversification. Concentric (Related) diversification is appropriate when an organization has a strong competitive position but industry attractiveness is low. Conglomerate (unrelated) diversification is an appropriate strategy when current industry is unattractive and that the organization lacks exceptional and outstanding capabilities or skills in related products or services. Generally, related diversification strategies have been demonstrated to achieve higher value creation (profitability and stock value) than unrelated diversification strategies (conglomerates). The interpretation of this finding is that there must be some advantage achieved through shared resources, experience, competencies, technologies, or other value-creating factors. This is the so called synergy effect of diversification i.e., ‘the whole is greater than the sum of its parts’. There are two types of diversification which are as follows:

- Related diversification (concentric diversification)
- Unrelated diversification (conglomerate diversification)

Related diversification (concentric diversification)

In this alternative, an organization expands into a related industry, one having synergy with the organization's existing lines of business, creating a situation in which the existing and new lines of business share and gain special advantages from commonalities such as technology, customers, distribution, location, product or manufacturing similarities, and government access. In essence, in concentric diversification, the new industry is related in some way to the current one. This is often an appropriate corporate strategy when an organization has a strong competitive position and distinctive competencies, but its existing industry is not very attractive. Thus, an organization is said to have pursued concentric diversification strategy when it enters into new product or service area belonging to different industry category but the new product or service is similar to the existing one with respect to technology or production or marketing channels or customers.

Unrelated diversification (conglomerate diversification)

Conglomerate diversification is a growth strategy in which an organization seeks to grow by adding entirely unrelated products and markets to its existing business. An organization that consists of a grouping of businesses from unrelated streams is called a conglomerate. In conglomerate diversification, an organization generally introduces new products using different technologies in new markets. A conglomerate consists of a number of product divisions, which sell different products, principally to their own markets rather than to each other. Conglomerates diversify their business risk through profit gained from profit centers in various lines of business.

Rationale for diversification

Under strict assumptions of an efficient market theory, there is no convincing rationale for one organization to acquire another, especially less efficient or unrelated businesses. Since the markets are imperfect and do not follow the norms of efficient market theory, organizations do diversify for several reasons given below:

Economies of Scale and Scope (Synergy): The merger of two organizations producing similar products should allow the combined organizations to pool resources and attain lower operating costs. The saving may come from reduced overheads or the ability to spread a larger amount of production over lower (consolidated) fixed costs. There may also be differential management capabilities. Efficiencies can also be gained through pooled financial resources or simply through pooled risk.

Widen Market Base and Enhance Market Power: Large number of collaborations and acquisitions are aimed at expanding the market for the organization's products. Mergers and acquisitions can increase an organization's market share when both organizations are in the same business. But, market share does not necessarily translate to higher profits or greater value for owners unless the merger substantially reduces the inter-organization rivalry in the industry.

Profit Stability: Acquisition of new business can reduce variations in corporate profits by expanding the organization's lines of business. This typically occurs when the core business depends on sales that are seasonal or cyclical. A large number of organizations pursue diversification strategy just to avoid instability in sales and profits which can result from events such as cyclical and seasonal shifts in demand, changes in the life cycles and other destabilizing forces in the micro and macro environment.

Improve Financial Performance: Large organizations generate cash that can be invested in other ventures. The organization acts as a banker of an internal capital market. The core business sustains itself on its moneymaking ventures, and uses this cash flow to create new ventures that generate additional profits. An organization may also be tempted to exploit diversification opportunities because it has liquid resources far in excess of the total expansion needs.

Growth: Diversification is basically a way to grow. Indeed, managers often cite growth as the principle reason for diversification. The most important factor that motivates management to diversify is to achieve higher growth rate than possible with intensification strategy. If the management feels that the existing products and markets do not have the potential to deliver expected growth, the only alternative they have is to diversify into new territories. Unlike organic growth, which is slow, an acquisition or merger (inorganic) can deliver the results rather quickly since resources, skills, other factors essential for faster growth are immediately available.

Counter Competitive Threats: Organizations are driven at times towards external diversification through merger by competitive pressures. Such a strategic move is expected to counter the competitive threats by reducing the intensity of competition.

Access to Latest Technology: Many Indian organizations enter into strategic alliances with foreign organizations to gain access to the latest technologies without spending huge amount of money on R&D.

Regulatory Factors: A large number of organizations have diversified their operations geographically to exploit opportunities in different regions and nations and also to take advantage of the incentives being offered by the various governments to attract investment. Many organizations enter other nations to avoid restrictions placed by the regulators in their host nation.

Activity 4

Compare and contrast the strategies of two different groups of conglomerates. Are they following concentric or conglomerate diversification?

.....

.....

.....

.....

9.7 ALTERNATIVE ROUTES TO DIVERSIFICATION

Once an organization opts for diversification, it must select one of the options discussed below. There are three broad ways to implement diversification strategies:

Mergers and Acquisitions

A merger is a legal transaction in which two or more organizations combine operations through an exchange of stock. In a merger only one organization entity will eventually remain. An acquisition is a purchase of one organization by another. In recent years, there were quite a few acquisitions in which the target organizations resisted the take-over bids. These acquisitions are referred to as hostile takeovers. It is natural for the target organization's management to try to defend against the takeover. Although they are used synonymously, there is a slight distinction between the terms 'merger' and 'acquisition'. This will be discussed more in detail in the later sections.

Strategic Partnering

Strategic partnering occurs when two or more organizations establish a relationship that combines their resources, capabilities, and core competencies to achieve some business objective. The three major types of strategic partnerships include: joint ventures, long-term partnerships, and strategic alliances which are discussed below:

Joint Ventures: In a joint venture, two or more organizations form a separate, independent organization for strategic purposes. Such partnerships are usually focused on accomplishing a specific market objective. They may last from a few months to a few years and often involve a cross-border relationship. One organization may purchase a percentage of the stock in the other partner, but not a controlling share.

Long-Term Contracts: In this arrangement, two or more organizations enter a legal contract for a specific business purpose. Long-term contracts are common between a buyer and a supplier. Many strategists consider them more flexible and less inhibiting than vertical integration. It is usually easier to end an unsatisfactory long-term contract than to end a joint venture.

Strategic Alliances: In a strategic alliance, two or more organizations share resources, capabilities, or distinctive competencies to pursue some business purpose. Strategic alliances often transcend the narrower focus and shorter duration of joint ventures. These alliances may be aimed at world market dominance within a product category. While the partners cooperate within the boundaries of the alliance relationship, they often compete fiercely in other parts of their businesses.

9.8 RETRENCHMENT STRATEGIES

Retrenchment is a short-run renewal strategy designed to overcome organizational weaknesses that are contributing to deteriorating performance. It is meant to

replenish and revitalize the organizational resources and capabilities so that the organization can regain its competitiveness. Retrenchment may be thought as a minor surgery to correct a problem. Managers often try a minimal treatment first—cost cutting or a small layoff—hoping that nothing more painful will be needed to turn the organization around. When performance measures reveal a more serious situation, more drastic action must be taken to restore performance. Retrenchment strategies call for two primary actions: cost cutting and restructuring. One or both of these tools will be employed more extensively in turnaround situations, because the problems are deeper there than in retrenchment situations. Retrenchment strategy alternatives include shrinking selectively, extracting cash for investment in other businesses, and divestment. While these strategies result in generating cash, they differ in terms of their intentions. Divestment of the whole business is an “end game” strategy and it may be done via selling or liquidation of business. Under the strategy of extraction of cash for investment in other business, cash is generated from the troubled business mainly via budget and cost contraction. In both strategies, the intention of management is to quit the troubled business.

In the shrinking selectively strategy (SSS), cash is generated via downsizing (contraction of size or divesting some operations. The strategy of shrinking selectively involves retrieving the value of investments in some parts of the market while reinvesting in others because in some niches’ demand will continue to be grow while in others the demand shrivels. The objective is to capture the desirable niches. Shrinking selectively as a repositioning strategy (i.e., matching market niche with distinctive competence) often results in renewed strength.

There are three major variants of retrenchment strategy which are:

- Turnaround strategy
- Survival strategy
- Liquidation strategy.

These are discussed in detail below.

Turnaround strategy

A turnaround situation exists when an organization encounters multiple years of declining financial performance subsequent to a period of prosperity. Turnaround situations are caused by combinations of external and internal factors and may be the result of years of gradual slowdown or months of precipitous financial decline. The strategic causes of performance downturns include increased competition, raw material shortages, and decreased profit margins, while operating problems include strikes and labour problems, excess plant capacity and depressed price levels. The immediacy of the resulting threat to organization survival posed by the turnaround situation is known as situation .Low levels of severity are indicated by declines in sales or income margins, while extremely high severity would be signaled by imminent bankruptcy. The recognition of a relationship between cause and response is imperative for a turnaround process and hence, the importance of properly assessing the cause of the turnaround situation so that it could be the focus of the recovery response is very important.

The Turnaround Process begins with a depiction of external and internal factors as causes of an organization's performance downturn. If these factors continue to detrimentally impact the organization, its financial health is threatened. Unchecked financial decline places the organization in a turnaround situation. A turnaround situation represents absolute and relative-to-industry declining performance of a sufficient magnitude to warrant explicit turnaround actions. A turnaround is typically accomplished through a two stage process. The initial stage is focused on the primary objectives of survival and achievement of a positive cash flow. The means to achieve this objective involves an emergency plan to halt the organization's financial hemorrhage and a stabilization plan to streamline and improve core operations. In other words, it involves the classic retrenchment activities i.e. liquidation, divestment, product elimination, and downsizing the workforce.

Retrenchment is an integral component of turnaround strategy. The critical role of retrenchment in providing a stable base from which to launch a recovery phase of the turnaround process is well established. Many organizations that have achieved a reversal of financial or competitive decline inevitably refer to the presence of retrenchment as a precursor or prelude to the implementation of a successful recovery strategy. Consequently, retrenchment may be necessary to stabilize the situation by securing or providing slack regardless of the subsequent recovery strategy that is chosen.

The second phase involves a return-to-growth or recovery stage and the turnaround process shifts away from retrenchment and move towards growth and development and growth in market share. The means employed for achieving these objectives are acquisitions, new products, new markets, and increased market penetration. The importance of the second stage in the turnaround situation is underscored by the fact that primary causes of the turnaround situation have been associated with this phase of the turnaround process- the recovery response. Recovery is said to have been achieved when economic measures indicate that the organization has regained its pre-downturn levels of performance.

Between these two stages, a clear strategy is needed for an organization. As the financial decline stops, the organization must decide whether it will pursue recovery in its retrenchment- reduced form through a scaled-back version of its preexisting strategy, or whether it will shift to a return-to-growth stage. It is at this point that the ultimate direction of the turnaround strategy becomes clear. Essentially, the organization must choose either to continue to pursue retrenchment as its dominant strategy or to couple the retrenchment stage with a new recovery strategy that emphasizes growth. The degree and duration of the retrenchment phase should be based on the organization's financial health.

Activity 5

Scan business dailies in the last few months or browse the Internet for organizations that implemented turnaround strategy successfully. Discuss the important issues involved in these cases.

.....

.....

.....

Survival strategy

When the organization is on the verge of extinction, it can follow several routes for renewing the fortunes of the organization. These are discussed in the following sections.

Divestment: An organization divests when it sells a business unit to another organization that will continue to operate it.

Spin-Off: In a spin-off, an organization sets up a business unit as a separate business through a distribution of stock or a cash deal. This is one way to allow a new management team to try to do better with a business unit that is a poor or mediocre performer.

Restructuring the Business Operations: The organization tries to survive by restructuring its management team, financial reengineering or overall business reengineering. Business reengineering involves throwing aside all old business processes and starting from scratch to design more efficient processes. This may cut costs and assist a turnaround situation. This is much easier to visualize in a manufacturing process, where each step of assembly is examined for improvement or elimination. It would be foolish to find more efficient ways to perform processes that should be abandoned and hence, reengineering is strongly suggested in such cases.

Liquidation strategy

Liquidation is the final resort for a declining organization. This is the ultimate stage in the process of renewing organization. Sometimes a business unit or a whole organization becomes so weak that the owners cannot find an interested buyer. A simple shutdown will prevent owners from throwing good money after bad once it is clear that there is no future for the business. In such a situation, liquidation is the best option. Bankruptcy is a last resort when the business fails financially. The court will liquidate its assets. The proceeds will be used to pay off the organization's outstanding debts. Some organizations file for bankruptcy instead of liquidating. Under this option, the organization reorganizes its operations while being protected from its creditors. If the organization can emerge from bankruptcy, it pays off its creditors as best as it can.

9.9 SUMMARY

Strategy refers to how a given objective will be achieved. Therefore, strategy is concerned with the relationships between ends and means, that is, between the results we seek and the resources at our disposal. There are three levels of strategy, namely, corporate strategies, competitive strategies and functional strategies. Corporate strategies sets the overall direction the organization will follow. On the other hand, competitive strategies determine how the organization will compete in a specific business or industry. Functional strategies, also referred to as operational strategies, are the short-term (less than one year), goal- directed decisions and actions of the organization are various functional departments.

There are various approaches to developing stability strategy. They are holding strategy, stable growth, harvesting strategy, profit or endgame strategy. Growth of business organizations implies realignment of its business operations to

different product–market environments. This is achieved through the basic growth approaches of intensive expansion, integration (horizontal and vertical integration), diversification and international operations have been covered in this unit.

Diversification involves moving into new lines of business. Of the various routes to expansion, diversification is definitely the most complex and risky route. Diversification of an organization can take the form of concentric and conglomerate diversification. An organization is said to pursue concentric diversification strategy when it enters into new product or service areas belonging to different industry category but the new product or service is similar to the existing one in many respects.

Retrenchment strategies normally followed by organizations during their decline stage. Retrenchment is a short-run renewal strategy designed to overcome organizational weaknesses that are contributing to deteriorating performance. It is meant to replenish and revitalize the organizational resources and capabilities so that the organization can regain its competitiveness. Overall this unit gives an idea about various corporate strategies which at one point of time the organizations use.

9.10 KEYWORDS

Corporate Strategies	: Corporate strategy is essentially a blueprint for the growth of the organization.
Competitive Strategies	: Strategies that determine how the organization will compete in a specific business or industry.
Combination Strategy	: Combination strategy may include combination of two alternatives i.e., market penetration and market development or combination of both the alternatives.
Diversification	: the organization grows by diversifying into new businesses by developing new products for new markets.
Expansion Strategies	: Growth or expansion strategy is the most important strategic option, which organizations pursue to gain significant growth as opposed to incremental growth envisaged in stable strategy.
Functional Strategies	: Also called operational strategies, these are the short-term, goal-directed decisions and actions of the organization's various functional departments.
Generic Corporate Strategies	: The four variants of corporate strategy, namely, stability strategy, growth/expansion strategy, retrenchment/divestment strategy and combination strategy are called generic corporate strategies or grand strategies.

Harvesting Strategy	: The organization has a dominant market share, which it wants to leverage to generate cash for future business expansion.
Integration Strategy	: The combination or association with other organizations to expand externally is termed as integration strategy.
Intensification Strategy	: Intensive expansion strategy involves safeguarding its present position and expanding in the organization's current product-market space to achieve growth targets.
International Expansion	: Global expansion involves establishing significant market interests and operations outside an organization's home nation.
Product Development	: The organization develops new products targeted to its existing market segments.
Stability Strategy	: Strategy, which aims to retain present strategy of the organization at the corporate level by focusing on its present products and markets.
Strategy	: Strategy refers to how an organization plans to achieve a given objective.
Concentric Diversification	: An organization is said to have pursued concentric diversification strategy when it enters into new product or service area belonging to different industry but the new product or service is similar to the existing one with respect to technology or production or marketing channels or customers.
Conglomerate Diversification	: Conglomerate diversification is a growth strategy in which an organization seeks to grow by adding entirely unrelated products and markets to its existing business.
Diversification	: Diversification involves moving into new lines of business.
Divestment	: An organization divests when it sells a business unit to another organization that will continue to operate it.
Liquidation	: It is the final resort for a declining organization. This is the ultimate stage in the process of renewing organization.
Turnaround Strategy	: It is a strategy adopted by organizations to arrest the decline and revive their growth.

9.11 SELF-ASSESSMENT QUESTIONS

- 1) What is corporate level strategy? Why is it important for a diversified organization?
- 2) What are the various reasons that organizations choose to move from either a single- or a dominant-business position to a more diversified position?
- 3) What do you mean by stability strategy? Does this strategy mean that an organization stands still? Explain.
- 4) Under what circumstances do organizations pursue stability strategy? What are the different approaches to stability strategy?
- 5) What resources and incentives encourage an organization to pursue expansion strategies? What are the main problems that affect an organization's efforts to use an expansion strategy?
- 6) Given the advantages of international expansion, why do some organizations choose not to expand internationally?
- 7) What is meant by diversification? What are the pros and cons of a diversification strategy?
- 8) What are the conditions under which organizations adopt retrenchment strategies? Briefly describe the variants of these strategies.
- 9) What is a turnaround strategy? Describe the different steps involved in turnaround process.

9.12 REFERENCES AND FURTHER READINGS

Bibeault, D. G. (1998). *Corporate turnaround: How managers turn losers into winners*. New York: McGraw-Hill.

Collis, D. J. & Montgomery, C. A. (2005). *Corporate Strategy: A Resource-based Approach*. United Kingdom: McGraw-Hill/Irwin.

Furrer, O. (2016). *Corporate Level Strategy: Theory and Applications*. United Kingdom: Taylor & Francis.

Goold, M., Campbell, A., Whitehead, J. & Alexander, M. (2014). *Strategy for the Corporate Level: Where to Invest, What to Cut Back and How to Grow Organizations with Multiple Divisions*. Germany: Wiley.

Hotchkiss, E. & Altman, E. I. (2010). *Corporate Financial Distress and Bankruptcy: Predict and Avoid Bankruptcy, Analyze and Invest in Distressed Debt*. Germany: Wiley.

Ireland, R. D., Hitt, M. A. & Hoskisson, R. E. (2014). *Strategic Management: Concepts and Cases: Competitiveness and Globalization*. United States: Cengage Learning.

Johnson, G., Whittington, R. & Scholes, K. (2009). *Exploring Corporate Strategy: Text & Cases*. United Kingdom: Financial Times Prentice Hall.

Porter, M.E. (1987). *From Competitive Advantage to Corporate Strategy*, Harvard Business Review, 65 (3); 43-59.

Ramaswamy, V. S. & Namakumari, S. (2000). *Strategic Planning Formulation of Corporate Strategy: Text and Cases: Indian Context*. India: Macmillan India.

Schmitt, A. (2009). *Innovation and Growth in Corporate Restructurings: Solution Or Contradiction*. Germany: GablerVerlag.



ignou
THE PEOPLE'S
UNIVERSITY

BLOCK 4

**STRATEGY IMPLEMENTATION
AND CONTROL**

BLOCK 1 STRATEGY IMPLEMENTATION AND CONTROL

This block deals with the implementation, control and evaluation part. It is divided into four units.

Unit 10: Implementation-Behavioural Dimensions: This unit deals with the behavioural aspects. The emphasis is more on the concept of leadership and its importance in strategic management.

Unit 11: Corporate Governance: This unit discusses the evolution of corporate governance and the role of business ethics in implementing corporate governance. The unit discusses different models of corporate governance. It also discusses the relationship of strategy with corporate governance.

Unit 12: Control: discusses the strategic control process and the importance of strategic control in evaluation. This unit also discusses different methods used in the control process and the follow-up action for control.

Unit 13: Evaluation: focuses on the concept of process of evaluation and discusses different qualitative measures, which are used for evaluation. In this unit the concept of Balanced Score Card is also discussed to develop a good understanding of performance evaluation system.

In all, this block discusses the various aspects of implementation of strategy and its control.

ignou
THE PEOPLE'S
UNIVERSITY

UNIT 10 IMPLEMENTATION - BEHAVIOURAL DIMENSIONS

Objectives

After reading this unit, you should be able to:

- Understand the concept of strategic change;
- Explain the role of leadership in strategic management;
- Discuss the concept of leadership;
- Acquaint yourself with various functions of leaders;
- Understand different leadership styles; and
- Understand the importance of ethics and values.

Structure

- 10.1 Introduction
- 10.2 Strategic Change
- 10.3 Matching Organization Structure to Strategy
- 10.4 Leadership
- 10.5 Functions of Leadership
- 10.6 Leadership Styles
- 10.7 Corporate Culture
- 10.8 Ethics and Values
- 10.9 Summary
- 10.10 Keywords
- 10.11 Self-Assessment Questions
- 10.12 References and Further Readings

10.1 INTRODUCTION

Successful execution/implementation of strategy depends on the appropriateness of the internal organization which to a large extent is reflected in the structure. Structure represents the network of relationships within an organization over a fairly long period of time. The matching of structure to strategy is important as there are alternative forms of structural designs which an organization can use. A certain organizational form may be more suitable for dealing with certain situation than others. For instance, a functional centralized form may be more suitable for a specialty manufacturing organization but unsuitable for an organization operating in a highly complex environment. Once a structure is established (or gets established), it is not easy to change it, for, it reflects the philosophy, prejudices and ambitions of management or owners and changing it may be perceived by

them as threatening. This defines the behavioural dimensions of the implementation aspect too. In the behavioural dimensions, leadership plays an important role.

Leadership means – to guide or to influence into an action. In today's highly competitive world, it becomes important for organizations to have a good leader. We know instinctively that in every human activity involving a group of people, there is a need for the guiding hand of a leader. The head of a family is the most ubiquitous leader since the dawn of human history. It is well accepted that on the quality and effectiveness of this leader, be it father or the mother, depends the progress and fortunes of the family.

In the modern complex society thousands of individuals are appointed or elected to shoulder roles and responsibilities of leadership in junior, middle and senior levels in factories and farms, schools and colleges, business and financial institutions, dispensaries and hospitals, in civil and military organs of the State's scientific and research institutions and so on. In this unit we present a holistic and practical approach to leadership as the behavioural dimension and how it helps in the successful implementation of the strategy.

10.2 STRATEGIC CHANGE

It is important for the organizations to find out the extent to which the change can be implemented. Each organization has an independent working style, therefore the strategies formulated for these organizations are also different. There can be different levels of strategic change depending on the nature of strategy.

While implementing a strategy, the whole process involves a number of people, tasks, business units and products to move from a stable strategy to organizational redirection. This is not an easy job as moving to organizational redirection means that organization is entering an entirely new industry. This requires lot of efforts and implementation process is quite complex. Therefore it becomes important for management to adapt to the changing times and manage the strategic change.

10.3 MATCHING ORGANIZATION STRUCTURE TO STRATEGY

An important question before the top management in an organization is: how to match the structure to the needs of the strategy? An organization, depending upon its size and objectives, may be pursuing several strategies simultaneously. There are no hard and fast rules to determine what kind of structure would be useful for which type of strategy. Each organization has its own history behind it and its managers have their own value systems and philosophies. The structure, therefore, is a result of these and several other variables. Moreover, each strategy rests on a set of key success factors or critical tasks. It is therefore desirable to design the organizational structure around the key success factors or critical tasks which are implied in the organization's strategy. This requires not only complete clarity on the key success factors (or critical tasks), but also requires making the units connected with the critical tasks or functions the main organizational building blocks. Further, the top management has to determine the degree of authority

that has to be delegated to each unit, bearing in mind the benefits and costs of centralization vs. decentralization. It has to decide how the coordination among different units of the organization would be brought about. We shall now discuss these three aspects briefly.

Strategy-Critical Activities

From the point of view of strategies, there are some activities which are critical to the success of those strategies while a large number of activities are of routine nature. The routine activities may be either maintenance or support type of activities e.g., handling pay rolls, accounting, complying with regulations, managing cash flows, controlling inventories and safe keeping of stores, training of manpower, public relations, market research etc. However, there are some critical tasks and functions which must be done exceedingly well for the strategy to be successful. For example, tight cost control is essential for an organization pursuing the strategy of low-cost leadership. This is particularly true if the margins are low and price cutting is widely used as a competitive weapon. For an organization which has chalked out 'differentiation' as its strategy, distinctiveness or sophistication in the design of its products is necessary. This needs emphasis on quality and excellence in workmanship. Thus, the activities that are critical to the strategy and competitive requirements may differ from organization to organization. Two alternative questions should help to identify strategy—critical activities: (i) what functions have to be performed exceedingly well for the strategy to succeed? or (ii) what are the areas where less than satisfactory performance would seriously endanger the success of strategy?

After the critical tasks or functions for a particular strategy have been identified, the next step is to group the various critical activities, along with routine and support activities associated with the critical activities, into organizational units or blocks. This would require a close look into the relationships that prevail within the organization. The flow of material through the production process, types of customers served, distribution channels used, sequence of operations to be performed, geographic locations are some of the bases for scrutinizing the relationships.

Degree of Authority (or decentralization)

After the grouping of activities has been done and units have been constituted, the next question to tackle with is the degree of decision-making authority that has to be delegated in the various units. Where the organization is engaged in several businesses, two alternative approaches can be followed. One is to centralize the strategic decision-making authority at the corporate level and delegate only operating decisions to the unit managers. The other is to substantially decentralize the strategic decisions to the unit managers, with the corporate staff providing necessary support to them. The corporate office in the latter case may limit its role to certain kinds of strategic decisions only. What should be the degree of authority given to the unit managers or how much autonomy should be given to them is essentially a question of managerial judgment and would depend upon a number of factors. The merits and demerits of decentralization in each situation must be properly weighed, after taking into consideration the principal decision the business unit managers make and how the corporate management perceives the importance of the various units in the overall strategy of the organization.

Providing for Coordination

Coordination among several units of the organization can be accomplished in several ways. The principal way is to position the various activities in the vertical hierarchy of authority. Managers higher up in the hierarchy generally have broader authority over several organizational units and this enables them to have more power to coordinate, integrate or arrange for the coordination of the units under their supervision. As far as business units are concerned, general managers are the central points in coordination because of their position of authority over the whole unit. Apart from positioning organizational units along vertical scale of managerial authority, a general manager can also achieve coordination of strategic efforts through informal meetings, special task forces, standing committees, and six monthly or quarterly strategic planning, budgeting and review meetings. Further, while formulating the strategic plan itself, a general manager can solicit the cooperation/association of other general managers in the planning process and this would provide for inbuilt coordination bridges right from the very beginning.

10.4 LEADERSHIP

Some researchers have shown that if the executives have good leadership qualities, the productivity of the nation can increase to a large extent without additional finance or new technology. It is important to note that the theoretical approach of leadership taught in classrooms is less effective than the practical approach. The only way is to find a method of improving the leadership potential of those already shouldering responsibilities and of those who are getting ready to enter the field of leadership in any walk of life. This is the basic philosophy of the practical and holistic approach to leadership - **‘it is perfectly possible to improve myself; I can hope to improve others only by personal example’** is its message.

Consequently the key to effective Strategic Management is to ensure that leadership runs like a uniform thread through all functions of management to integrate them into a culture of excellence. One of the primary needs for effective strategic management is to understand, in practical terms, the meaning of leadership, its functions; and, finally to ensure that effective leaders are groomed and developed at every level in an organization. Only then will strategic managers be able to conceive strategic plans and translate these plans into reality.

Activity 1

Has there been any change in the top leadership of the organization with which you are associated? If the answer is yes, explain in what ways it has affected the quality of strategic decisions and overall productivity.

.....

.....

.....

.....

.....

However, when it comes to evolving a definition or a theory of leadership we run into difficulties. “If we know too much about our leaders, we know far too little about leadership—is it essentially inspiration? Is the leader a definer of values? How do leaders lead followers without being wholly led by followers?”

Leadership is one of the most observed and least understood phenomena on earth. However, despite Maslow’s perceptive diagnosis, an integrated view on this vital and age-old function in human society has not yet crystallized. Commenting on group dynamics laboratories Maslow (1965) observed: “What I smell here is again some of the democratic dogma and pity in which all people are equal and in which the conception of a factually strong person or natural leader or dominant person or superior intellect or superior decisiveness or whatever is bypassed, because it makes everybody uncomfortable, and because it seems to contradict the democratic philosophy (of course, it does not really contradict it)” .Maslow made the above remarks as he was fully aware that there were serious reservations among intellectuals and scholars to the very concept of leadership. Potential for leadership has no relation to parental stations in society. Many of the outstanding leaders in history had a non-affluent background.

The fact that the literature on leadership has number of definitions of the word indicates that it is a complex process. However, its essential nature is the ability to get the best out of people. The definition which has the touch of practical common sense is the one evolved by a medical doctor-Lord Moran. He was the medical officer of a British Infantry Battalion during World War I. For two long years he served the Battalion in France and saw how young officers inspired their fellow citizens to fight the Germans with enthusiasm and courage, knowing well that many among them would get killed or maimed. He wondered how one individual could exercise such a decisive influence over others. It was not just the military law or discipline, because despite these there were examples of demeaning cowardice and inability to lead. About two decades later he rose to become the Chairman of the British Medical Council and later, during World War II, he was the personal physician to Sir Winston Churchill, the war time Prime Minister of Great Britain. In that unique capacity he had a ring- side seat to observe the top leaders of the world in every human activity—politics, industry, military, labour and so on. Given below is a definition which is based on what he evolved:

“Leadership is the capacity to frame plans which will succeed and the faculty to persuade others to carry them out in the face of all difficulties.” (Moran, 1984).

The definition has two parts. The first deals with the capacity to frame plans (programmes, projects or whatever) that have a high probability of success. This implies that a plan should reflect a leader’s grasp and feel of the quality of his/her resources and the environments in which the plan has to be implemented. The second part of the definition deals with the implementation of the plan by persuading others to do what is really expected of them, despite difficulties, discouragement and obstacles.

Leadership deals with the top line. What things I want to accomplish? In the words of both Peter Drucker and Warren Dennis ‘Management is doing things

right; leadership is doing the right things'. Management is efficiency in climbing the ladder of success; leadership determines whether the ladder is leaning against the right wall".

Let us now look at the functions of leadership.

10.5 FUNCTIONS OF LEADERSHIP

In practical terms a leader has to achieve the task (mission, objective or goal). For doing so, s/he has to build his/her team as a cohesive group and develop every individual in the team to give his/her very best. Consequently, s/he has to harmonize and integrate the needs related to the accomplishment of the task with those of the group he leads and individuals in the group. This is best explained diagrammatically by depicting these needs in three linked circles, as shown in Figure 10.1.

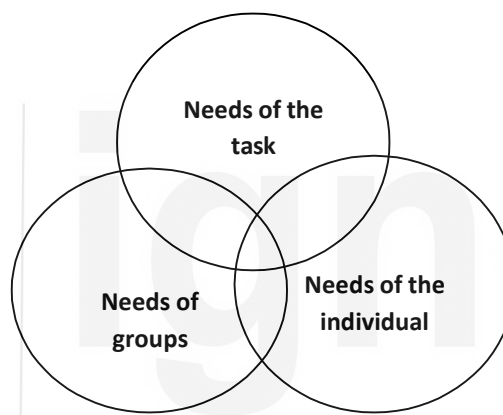


Figure 10.1: Functions of Leadership

Source: Adapted from Adair (1973)

1) Functions for needs of the task

- Defining the task
- Making the plan
- Allocating work and resources
- Controlling quality and tempo of work
- Checking performance against plan

2) Functions for needs of the individuals

- Attending to personal problems
- Praising of individuals
- Knowing individuals personally
- Recognizing and using individual abilities
- Training individuals

3) Functions of needs of the groups

- Setting standards

- Maintaining discipline
- Building team spirit
- Encouraging, motivating, giving a sense of purpose
- Appointing sub-leaders
- Ensuring communication within the group
- Training the group

The functions related to the needs of the three areas have been listed separately for easy understanding. In actual practice, however, most of these are integrated in the following steps:

- Planning to achieve the task by using the available resources and people;
- Initiating work by allocating tasks and resources;
- Controlling by monitoring the work; modifying plan;
- Supporting by encouragement and by motivating and training;
- Evaluating.

Activity 2

What functions do you think are the most important for a leader from strategic management point of view and why?

10.6 LEADERSHIP STYLES

The statement that a 'good leader varies his/her style between authoritarian to participative (autocratic to democratic) depending on the task, the changing situation s/he encounters and changing group that s/he has to lead' sums up rather briefly, the way an effective leader has to function. However, no effective leader ever consciously adopts a specific style. It comes naturally from within. Style invariably is the reflection of the substance.

In practical terms any change in style is merely an intuitive variation in the mix of personal example, persuasion and compulsion. Personal example is the most potent factor in the technique to inspire people to do what they are expected to do. If a leader can work 12 to 14 hours a day then the message gets across. Personal example in punctuality, integrity, honesty, frugality, courage, persistence, initiative unselfish love of people, or whatever is infectious with the Indian people. They try and live up to the standards of a leader. To do yourself what you expect your people to do is the secret of leading people.

There are people and there are times when persuasion is necessary to motivate people to do what has to be done. When they understand the circumstances, people do rise to the occasion and go through the most irksome tasks. The long-term persuasion lies in the organizational culture (*esprit de corps*) in which people take pride in doing anything to uphold the honour and good name of the organization.

Leadership in Indian Context

More and more organizations in the country are reflecting the diversity of Indian people. Executives and workers in organizations often hail from different parts of the country, speak different languages, have different customs and traditions, profess different religions and have different ethnic origin. For a leader to be able to handle such groups of people, s/he must be able to rise above his/her own narrow regional, religious, linguistic and ethnic origin, and project, by convictions and actions, a true all-India personality to be able to command, respect and loyalty of his team. There are two essential requirements for succeeding in this goal.

First, a leader should have a good grasp and pride in the long history and cultural ethos of India. Second, a leader should have rudimentary knowledge of all religions of India and s/he should genuinely respect all faiths.

Table 10.1 shows some attributes of successful leaders.

Table 10.1: Attributes of Successful Leaders

• Ambition • Willingness to work hard • Enterprise • Astuteness • Ability to 'stick to it' • Capacity for lucid writing • Imagination • Ability to spot opportunities • Willingness to work long hours • Curiosity • Understanding of others • Skill with numbers	• Ability to administer efficiently • Enthusiasm • Capacity to speak lucidly • Single mindedness • Willing to take risks • Leadership • Ability to take decisions • Analytical ability • Ability to meet unpleasant situations • Open mindedness • Ability to adopt quickly to change
---	---

Activity 3

Ponder over the leadership style of your immediate supervisor in the organization you are working with and answer the following:

a) How do you describe his/her leadership style?

.....

.....

.....

Is his/her leadership style consistent (or does it vary frequently)?

Developing appropriate leadership is one of the most important elements in the implementation of a strategy. This is important because leaders are key organic elements who help an organization cope with changes. Appropriate leadership is necessary, though not a sufficient condition, for mobilizing people, and for developing effective structure and systems for the success of strategy. Failure of leadership may lead to difficulties in achieving goal congruence, communication breakdown, ambiguity with regard to roles of sub-units, and difficulty in obtaining commitment to a plan, e.g., staff conflicts and lack of strategic thinking. Leadership is the key factor for developing and maintaining the right culture and climate.

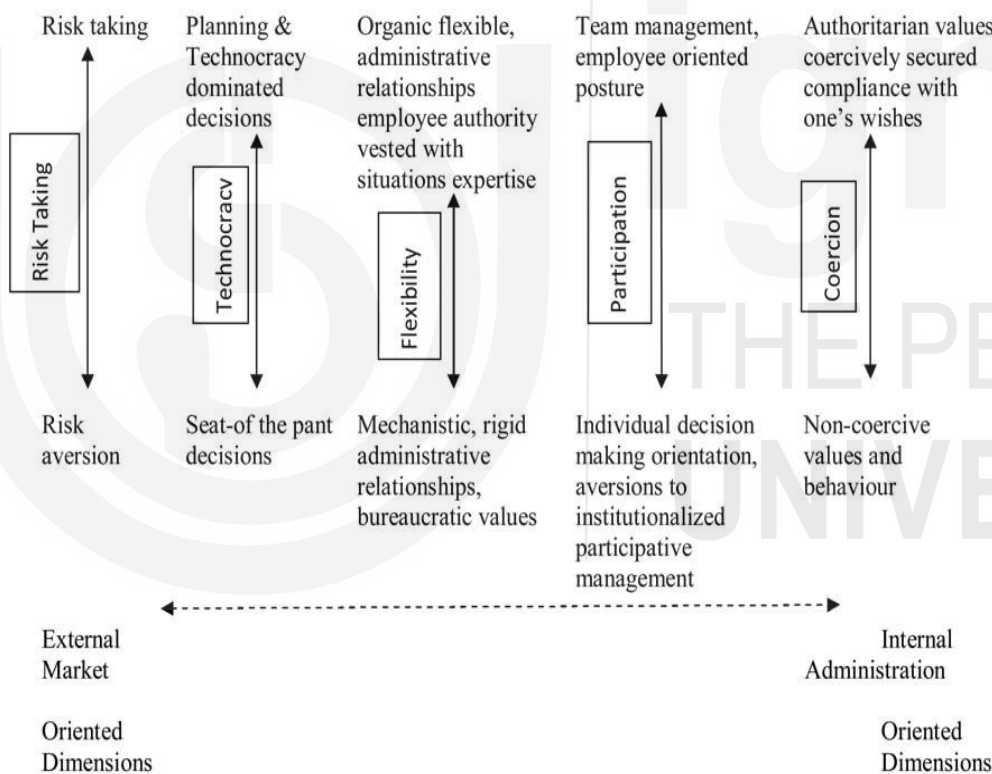


Figure 10.2: Dimensions of Leadership Styles

Source: Khandwalla, (1977)

There are several aspects of leadership styles and skills, some of them are more appropriate to the context/content of a strategy, while others are desirable attributes in general for the success of an organization. Leadership styles are manifested through the orientations. Khandwalla has identified five orientations (dimensions of style) namely, the risk taking (willingness to make high risk, high return decisions), optimization (degree of commitment to the use of planning, and management science techniques in decision making by technically qualified people vis-a-vis seat-or-the pant decisions), flexibility (degree of looseness and flexibility in organization structuring), participation (of those other than the ones

holding key positions) and coercion (use of fear and domination) as shown in figure 10.2.

For superior performance on key organization goals s/he proposes that if the:

- Orientation of top management is risk taking, then it should be at least moderately organic and coercive in proportion to internal resistance to change;
- Orientation is risk averse, then it should be moderately mechanistic and non-coercive;
- Orientation is of highly optimization type, then it should be strongly participative;
- Orientation is highly seat-or-the-pant and non-technocratic, then it should be at least moderately risk taking and non-participative.

Different leadership styles have “good fit” with different environments. Since the strategy determines the product/market scope, and also the environment in which the organization is going to operate in future, it has a bearing on leadership style. Khandwalla has further categorized leadership styles into seven types to relate them to environment, each reflecting different mix of the five orientations, as shown in the table 10.2.

Table 10.2: Seven Styles of Top Management

<i>Leadership Style</i>	<i>Risk Taking</i>	<i>Technocracy (Optimization)</i>	<i>Flexibility Organicity</i>	<i>Participation</i>	<i>Coercion</i>
Entrepreneurial	High	Moderate to low	Moderate to high	Moderate to low	Variable
Neo-scientific	Variable	High	Moderate to low	High	Moderate to low
Quasi-scientific	Variable	High	Moderate to low	Moderate to low	Moderate to high
Muddling through	Moderate to low	Low	Moderate to high	Moderate to low	Moderate to high
Conservative	Low	Moderate to low	Moderate to low	Moderate to low	Variable
Democratic	Moderate to low	Moderate to low	Moderate to high	High	Variable
Middle of the Road	Moderate	Moderate	Moderate	Moderate to low	Moderate to low

Source: Khandwalla, (1977)

Like leadership, there are several dimensions of environment also, namely, the degree of turbulence/volatility (high degree of changeability/unpredictability), hostility (hostile environment are highly risky and overwhelming), heterogeneity (diversity of markets/consumers), restrictiveness (economic, social, legal and political constraints) and the degree of technological sophistication. The leadership styles which are more appropriate to different types of environment are shown in Table 10.3.

Table 10.3: Environment-Style Fit

<i>Environment</i>	<i>Level</i>	<i>Styles</i>
Turbulence	High	Entrepreneurial, neo scientific
	Medium	Neo scientific, middle of the road
	Low	Conservative
Hostility	High	Entrepreneurial
	Medium	Neo scientific
	Low	Neo scientific, Conservative
Diversity	High	Entrepreneurial, Neo scientific
	Medium	Muddling through, middle of the road
	Low	Neo scientific, conservative, entrepreneurial, quasi-scientific
Restrictiveness	High	Neo scientific, entrepreneurial
	Medium	Entrepreneurial, conservative
	Low	
Technological Complexity	High	Entrepreneurial, Neo scientific
	Medium	Quasi-scientific
	Low	Democratic

It should be noted that while the above discussion gives a good idea of orientations and the styles of leadership to respond effectively to the environmental demands, it does not cover the leadership skills required for “revitalization” or “transformation” of the “organization”. The above discussion gives the attributes of a manager who is a “transactional” leader, and not a “transformational” leader. The task of a “transformation” or “revitalization” leader is to take the organization to a dominant position. This involves managing change or transition. It has three distinctive phases.

- Recognizing the need for revitalization
- Creating a new vision
- Institutionalizing change.

The leadership task in the first phase requires the ability to sense the need for change (often there is a low threshold to catch trigger events in the environment). The second phase requires communication skills to create a vision for future that excites people to move, and also the interpersonal skills and creativity to mobilize commitment of at least at critical mass in the organization. To perform the task in the third phase of the transformation process the leader should have the ability to understand and manage powerful conflicting forces in people. The negative emotions and threats to power and authority have to be transformed into positive emotions and reconciliation. New ways of working, new styles, new culture, and new norms have to be developed. The shock of change has to be reduced.

The challenges of leadership in implementation are grave as leadership is the scarcest resource. Organizations cope with it in several ways, by changing the

current leadership and by developing appropriate leadership styles. The change of current leadership may not be easy to achieve even though it might be inevitable for effecting “transformation” in the situation. The existing leadership might have been cast in a particular mold which may be inappropriate to the demands of the organization. The “casting” effect can be overcome if changes are introduced gradually in the leadership styles and skills, to avoid accumulated lags or mismatches between existing leadership styles/skills and organization’s changed requirements. This would require a blueprint to indicate the kinds of styles and skills, and the number of persons of different styles and skills required in future, current talent available and a plan of recruitment and grooming. The task of human resources development is thus very closely related and determined by strategy of the organization.

Activity 4

Describe basic features of the top management styles in your organization. Compare them with the styles necessary to match the demands of your organization.

.....

.....

.....

.....

.....

.....

10.7 CORPORATE CULTURE

Each organization has its own way of dealing with corporate problems and do have their own organizational structure. The culture of the organization very much depends on the behaviour of the employees. If the employees have a strong commitment towards their organizations, the organization is said to have a strong culture and vice versa. It is not easy to have a strong culture in the organization. Lot of it depends on how the leaders of the organization handle their employees. Looking at this discussion, we can infer that 'corporate culture' is the values and beliefs accepted and practiced by all the employees of the organization. To have an appropriate corporate culture, the strategy of the organization should match with it. In this section we would stress more on the role of leaders in shaping the culture of the organization and will discuss the role of leaders in handling the employees.

When it comes to handling people, the total personality of a leader comes into play. Managerial effectiveness is the management terminology for leadership. It is well to remember that this truth is applicable at all the levels of management-Junior, Middle and Senior. The 'Katz Model', shown in Figure 10.3 shows the relevant value of management skills at various levels. Although there have been some minor changes in the original design, it clearly shows that Human Relation Skill is consistently the biggest component at all the levels of management.

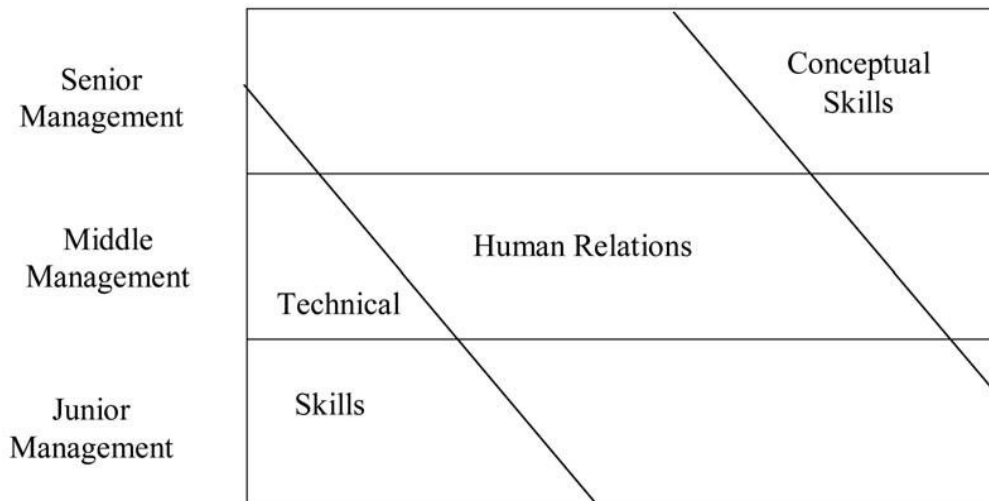


Figure 10.3: Katz Model-Skills of an Effective Manager

A leader in any organization has to handle people in the following three directions:

- The first is downwards-his/her own team which s/he has to build as an effective and cohesive group motivated to achieve the goals of the organization.
- The second is lateral, which involves winning the support and cooperation of colleagues over whom the leader has no control, but who have an important functional relationship with the group/organization headed by the leader.
- The third is a purposeful, constructive and harmonious relation with the higher authority under whom a leader functions-the boss.

Human nature: In order to handle people effectively it is useful for a leader to understand human nature. There are a large number of theories about it. For developing leadership potential it is useful to focus our attention on two concepts which have a lasting and practical value for learners.

Once people are convinced that s/he is a person who knows them well and s/he truly cares about them then they would do anything for the leader. However, it requires a very major effort to know people and know them better than even their own mothers - effort in terms of time, attention and genuine interest in people.

Communication: To know people: The ability to know people is the starting point to handle them and communication skill plays an important role in this ability. These help a leader TO TELL what s/he wants done. However, some essential features of this skill relevant to knowing and handling, people need discussion.

Most of the strained and fractured relations can be traced to the mutual breakdown of communications between individuals in a family, group, community, countries and even among the community of nations. The ability to communicate puts human relations on an even level by removing misperceptions and misunderstandings. The ability has two sides:

- The skill of expression; and
- The skill of listening.

The Skill of Expression

The skill of expression does not merely mean gift of the gab or cleverness with words. For a leader the skill of expression is a vehicle to generate trust. Verbal expression counts for only 30 per cent in this skill, the balance 70 per cent is the body language-expression in the eyes, conviction in the tone, the sincerity in the posture, and generally, the vibrations that a person conveys. Body language communicates the total personality of a leader, and its effectiveness depends, entirely on the strength and balance of the "Universal Inner Structure of Effective Leaders". In genuine expression there can be no pretension. Spontaneity, straight-forwardness and sincerity are far more effective than sheer command over the language.

The Skill of Listening

The skill of listening means understanding and knowing the other person. It has been found that this part of communication skill is even more important, but, unfortunately less prevalent. Listen with ears and observe body language with eyes. Even nature has a design in the listen talk ratio. Listening has three ingredients. The first, of course, is the physical process of hearing what the other person is saying; this involves attention. Comprehending what the person is saying is the second ingredient, and demands undivided attention. Looking out of the window, or attending to routine papers while listening are signs of inattentiveness. Remembering what you listen is the third ingredient of this skill and, naturally, comes about only if a leader hears and comprehends what is said. The ability to listen attentively and with sympathy, in which a leader shows signs of warmth, makes the other person feel that s/he is an individual and not merely a faceless part of the machine. It helps generate trust in the team.

Experience shows that effective communication means:

- 50 per cent listening;
- 25 per cent speaking;
- 15 per cent reading;
- 10 per cent writing.

Handling people working for a leader

Self-control: No team captain can hope to control and inspire his/her team unless s/he learns to control and discipline himself. This is a difficult task, but without it there is little chance for a man to become a successful leader. It requires a certain amount of philosophical outlook and frugality which is often associated with aristocrats and saints. Self-control does not only add to the leadership potential, it also is a source of great happiness.

Success and Failure: It is a basic trait of human nature that an individual ascribes successes of an organization to the part played by him/her, and blames failures on the system. On the other hand, a good leader gives credit

to his/her employees for successes and takes responsibility for failures. This approach binds men together in a collective effort to work for the organization.

Setting Targets: It is useful to let individuals themselves set targets for work. In this event not only are they likely to meet these targets, but even surpass them.

Correcting Mistakes: A leader often corrects the people who falter or show traces of weakness or fail. It is better to say "This is not what is expected of a person of your caliber and ability" rather than words to the effect "what else one could expect from a clot like you". The first approach enhances a man's self-respect even in failure. The second approach makes him your enemy.

We and not you: A good leader always projects him/her as a part of the team and invariably talks in terms of "We" and not "You".

Accessibility: It is a leader's responsibility to ensure that s/he is accessible. S/he should institutionalize the time and place for meeting the members of his team.

Tragedies and illnesses are a frequent occurrence in human life. A good leader makes it a point to find time for seeing men who are afflicted to who have difficult problems to tackle. Visiting them, in case they are hospitalized, should also be a matter of priority time allocation. You win lasting commitment from people thus handled.

Anger: A good leader does not lose his/her temper. However, righteous anger is very different from uncontrolled rage and should not be suppressed. However, special care should be taken to uphold the honour and dignity of an individual in the presence of his colleagues and family members.

Recognition: Good and effective leaders have used the human urge for recognition with telling effect to foster interpersonal bonds with their people and to motivate them. They have scrupulously used the principle of 'praise in public and reprimand in private' to create an organizational culture in which people work 'much beyond call of duty' to maintain excellence in their organization. The real basis of making individuals feel like heroes is, of course, genuine care and unselfish love by the leader for his people.

In the ultimate analysis, handling people is a matter of attitude. It is expecting the utmost from them while caring for them completely. It is possible only if a leader can create an atmosphere in which there is free communication. Tolerating shirkers and parasites in the name of "being human" does a great deal of damage. Fortunately, such people are few and far between, and must be dealt with strictly.

10.8 ETHICS AND VALUES

It is not easy to build a strong corporate culture in any organization. A strong culture is based on strong ethics and values. This is very important for the success of the organization in the long-run. It is very easy to adopt short-cut methods to reach the top but the downfall also comes at the same rate. Ethics and values ensure that the organization does not adopt short-cut methods to achieve success; instead it stresses on the concept of sustained success. Every organization has its own code of ethics and standards in a written form.

The code of ethics normally contains the following points:

- Honesty
- Fairness in practices of the organization-Disclosing the inside information;
- Acquiring and using outside information-Disclosure of outside activities by the employer to the employee;
- Using organization assets; etc.

The value statements normally include

- Value of customers;
- Commitment towards the business practices like quality etc.;
- Duty towards shareholders, suppliers etc.;
- Following the environmental protection norms etc.

These were the few areas which were covered. There can be more such points, which can be discussed under the head value statements and code of ethics. Each organization has its own set of value statements and code of ethics.

Activity 5

Take the case of the organization of your choice and write the code of ethics and value statements of that organization.

.....

.....

.....

.....

For the strategy to be implemented effectively, it is important to have a set of formal value statements and code of ethics. These should not be merely in a written form but must be followed by each employee of the organization so as to create a strong corporate culture, which in turn would result in the success of the organization.

10.9 SUMMARY

In this unit we have discussed different aspects of behavioural issues, which are important for the implementation of a strategy in an organization. In this unit, the stress is more on the concept of leadership and the role of leaders in handling the people. The key to effective strategic management lies in ensuring the integration of the functions of management into a culture of excellence. This in itself is a great challenge for leadership.

Whether a leader should change his/her style in according with the demands of the situation is rather controversial. It is considered better for a leader 'to be him/her'. The role of leader is important for maintaining the corporate culture of the organization. S/he should set examples to guide his employees to follow a path of sound values and ethical principles so as to build a strong corporate culture.

10.10 KEYWORDS

Corporate Culture is the values and beliefs accepted and practiced by all the employees of an organization.

Ethics is the moral philosophy of the organization.

Leadership is the capacity to frame plans which will succeed and the faculty to persuade others carries them out in the face of all difficulties.

Values are the moral principles of the organization.

10.11 SELF-ASSESSMENT QUESTIONS

- 1) "12 per cent of effective management strategy is knowledge and 88 per cent is dealing appropriately with people". Do you agree with the statement? Discuss.
- 2) Discuss the role of leadership in
 - a) Strategic Management
 - b) Improving Productivity
- 3) Discuss the different functions of leadership.
- 4) Should a leader change his/her style or continue with his/her style, which is in consonance with his/her basic personality? Discuss.
- 5) What do you understand by corporate culture? Should the organization have a corporate culture of its own? Discuss.
- 6) Briefly explain the importance of values and ethics in an organization.

10.12 REFERENCES AND FURTHER READINGS

Adair, J. E. (1973). *Action-centred leadership* (pp. 07-084428). New York: McGraw-Hill.

Adair, J. (2011). *Effective Strategic Leadership*. United Kingdom: Pan Macmillan.

Aquinas (2009). *Organization Structure & Design: Applications And Challenges*. India: Excel Books.

Khandwalla, P.N. (1976) "Some Top Management Styles: Their Context and Performance". *Organization and Administrative Sciences*. Vol. 7(4). p. 27.

Khandwalla, P.N. (2001). *Organizational Designs for Excellence*. India: McGraw-Hill Education Pvt Limited.

Rao, P. S. (2017). *Business policy and strategic management*. India: Himalaya Publishing House.

Hitt, H.M. (2017). *The Oxford Handbook of Strategy Implementation*. United States: Oxford University Press.

Stowell, S. J. & Mead, S. S. (2016). *The Art of Strategic Leadership: How Leaders at All Levels Prepare Themselves, Their Teams, and Organizations for the Future*. Germany: Wiley.

UNIT 11 CORPORATE GOVERNANCE

Objectives

After going through this unit you should be able to:

- Know the evolution of corporate governance;
- Acquaint yourself with five pillars of corporate governance;
- Understand the various drivers of corporate governance;
- Discuss the models of corporate governance.

Structure

- 11.1 Introduction
- 11.2 Evolution of corporate governance
- 11.3 Business Ethics
- 11.4 Pillars of corporate governance
- 11.5 Models of corporate governance
- 11.6 Corporate governance and Strategy
- 11.7 Challenges of corporate governance
- 11.8 Summary
- 11.9 Key-words
- 11.10 Self-Assessment Questions
- 11.11 References and Further Readings

11.1 INTRODUCTION

The growth of corporate sector and the competitive market has together introduced the concept of corporate governance. Corporate governance has become an integral part of business life so as to achieve the objectives and to protect the organizations from failure in future. There are two aspects which are important to understand the corporate governance: a) the internal structure which includes the management, board structure etc. and b) the external structure which includes shareholders and other stakeholders. This helps in ensuring an efficient internal control, robust management structure, appropriate performance measures and effective succession plans. At the domestic as well as international fronts, the organizations have been applying corporate governance as codes of best practices and have set examples for others. In this unit we will discuss the basics of corporate governance and how it is related to strategy.

11.2 EVOLUTION OF CORPORATE GOVERNANCE

If we go back and see the Indian history way back in the third century B.C. we will find that Patliputra, the capital of the Mauryan Empire was said to be the

best example of a city which followed the best practices of governance. Chanakya in his book Arthshastra, mentioned the virtues of an ideal king which can be related to the chief of any organization. These virtues are:

- Well-being of the subjects;;
- Welfare of the subjects.

If these two are followed, then the king automatically will be happy and something which is desirable and beneficial to the subjects is desirable and beneficial to the king.

If we substitute the state with the organization and the king with the chief of the organization or the board of a company, and the subjects with the shareholders, the principles of corporate governance which is the belief that public good should be ahead of private good; and that the corporation's resources should not be used for personal benefit fits well. The duties of the king when applied for a business organization implies as follows:

- Protecting the shareholders wealth,
- Proper utilization of assets;
- Maintenance of wealth;
- Accountability and transparency.

The advent of company law happened in the middle of 19th century. This was basically done to protect the interests of the shareholders in the joint stock companies. The concept of Board of Directors (BOD) as trustees of the shareholders emanated from the need for appropriate governance structure. The BOD would be responsible for overseeing the management of the organization in order to protect the interests of the shareholders. As the time passed the ownership of shareholdings gradually shifted from individuals to institutional investors and also with privatization throughout the globe, control of assets shifted from State to market economy. This led to the views of various experts who felt good governance is a useful indicator of good performance in the market systems.

In the developed market economies, the concern for Board governance framework became important due to rise in corporate sector financial and related irregularities at different points of time especially during the twentieth century. This showed the inefficiency in the governance structure. Further, with the gradual opening up of the global economy, trade, investment and international financial market liberalization, the framework of effective corporate governance gained recognition. This was considered as an important instrument for sustained development of the world economy. Worldwide a series of expert committee reports led to the evolution of different codes of corporate governance to reflect the challenges of a competitive and globalised system.

There is no fixed way as to how corporate governance can be incorporated in an organization's strategy. There are different views and different experts have given different definitions of corporate governance. The dictionary meaning of governance includes both 'the action or manner of governing' and 'a mode of living, behaviour, and demeanor'. Corporate governance is essentially concerned with the process by which organizations are governed and managed.

It is a set of standards, which aims to improve the organization's image, efficiency, effectiveness and social responsibility. The concept of corporate governance primarily relies on complete transparency, integrity and accountability of the management, with an increasingly higher focus on investor protection and public interest. A key element of good governance is transparency projected through a code of good governance, which incorporate a system of checks and balances between key players – boards, management, auditors and shareholders.

The corporate governance framework in many countries of the world is largely inward-focused. It mainly highlights the composition of management structure at various levels. The composition at different levels is different assuming that the right structure will automatically ensure quality to delivery. All corporate governance systems depend on 5 key pillars which will be discussed later in this unit. These are:

1. Accountability
2. Fairness
3. Transparency
4. Integrity
5. Social responsibility

The challenges of upholding these pillars depend upon the ownership structure of the corporate. The corporate ownership structures are of two types: 1) "Insider" (concentrated) and 2) "Outsider" (dispersed). In the concentrated ownership structure, ownership control is concentrated in the hands of a small number of individuals, families, holding companies, banks or other non-financial companies. In this structure insiders exercise control over organization in different ways. The most common feature in this structure is that insiders own the majority of the shares of the organization with voting rights. Most nations, especially those governed by civil law, have concentrated ownership structure. In dispersed ownership structures, there are number of owners, each of whom holds a small number of shares of the organization. Small shareholders have little incentive to closely monitor organizations' activities and tend not be involved in management decisions or policies. Common law countries such as United Kingdom and United States tend to have dispersed ownership structure. Each ownership structure has its own corporate governance challenges.

Evolution globally

In the early 1990's in the United Kingdom, the United States and Canada began the modern trend of developing corporate governance guidelines and codes of best practice. This was in response to problems in the corporate performance of leading organizations, the perceived lack of effective board oversight that contributed to performance problems and pressure for change from institutional investors.

In the year 1992 in the United Kingdom, the Cadbury committee report, defined corporate governance as "the system by which organizations are directed and controlled", became a pioneering reference code for stock exchanges both in UK and abroad. General Motors Board of Directors Guidelines in the U.S., and

the Dey Report in Canada also proved to be influential sources for guidelines and code initiatives adopted by other countries.

in July 2003, in U.K., the Financial Reporting Council (FRC) of the U.K. published the new Combined code which was referred to as “U.K. code (2003)” thereafter. The U.K. Code (2003) was based on the proposed revision of the Cabined Code (1998), in the report by Derek Higgs on the role and effectiveness of non-executive directors, which incorporated the recommendations on audit committees by Robert Smith.

The most significant changes in the code were as follows:

- the expanded definition of independent director;
- an increase in the recommended proportion of independent directors from one-third to a majority of the Board for larger listed organizations;
- Separate Chairperson and CEO
- Chairperson being an independent director.
- Stringent guidelines on membership of the Audit Committee;
- Increased emphasis on the need for internal audit and control functions;
- Allows for some differences in corporate governance arrangements for larger and smaller organizations, particularly pertaining to the number and proportion of independent directors on the Board and number of members on certain Board committees.

Following various other committee recommendations in different nations of the world, there have been efforts to homogenize the code of corporate Governance, particularly in listed organizations. In the U.S., in 1998, the New York Stock Exchange (NYSE) and the National Association of Securities Dealers (NASD) sponsored a committee to study the effectiveness of audit committees. This committee was known as the **Blue Ribbon Committee** and was set up to improve the effectiveness of Corporate Audit Committees. In its 1999 report, the Blue Ribbon Committee recognized the importance of audit committees and issued ten recommendations to enhance their effectiveness. In response to these recommendations, the NYSE and the NASD, as well as other exchanges, revised their listing standards relating to audit committees.

In 2002, the **Sarbanes-Oxley Act** was passed in response to a number of major corporate and accounting scandals involving prominent companies in the United States. This Act is considered to be one of the most significant changes to federal securities laws in the United States. An interesting aspect in the Sarbanes Oxley Act is the protection to whistleblowers.

The Organization for Economic co-operating and Development (OECD) Principles of Corporate Governance, originally adopted by the 30 member countries of the OECD in 1999, have provided a good insight into corporate governance framework at a macro level. Following an extensive review process that led to adoption of revised OECD Principles of Corporate Governance 2004, they now reflect a global consensus regarding the critical importance of good corporate governance in contributing to the economic viability and stability of

our economies. OECD Principles of Corporate Governance reflects not only the experience of OECD countries but also that of emerging and developing economies.

11.3 BUSINESS ETHICS

When we talk about ethics, it relates to the demarcation between right and wrong. It is actually the moral values and certain codes of conduct which are presumed to be followed by an individual as well as an organization. Garret has defined ethics as “the science of judging specifically human ends and the relationship of means of those ends. In some way it is also the art of controlling means so that they will serve specifically human ends”. There are many such definitions but at the end of the day we can say that there are no fixed set of rules which can define as the action right or wrong. Ethics is not legally defined but it does not permit to violate the laws. Role of ethics and values is quite important for business organization and we call it as business ethics.

Business Ethics: As the name suggests, it deals with certain sets of rules of any business organization. It is the set of permissible rules which have a positive impact to the organization. It deals with certain set of values of the organization leading to the socially responsible behaviour of the organization. In a nutshell we can say that it is the application of ethical principles in a business organization. There are certain common features of business ethics which are as follows:

1. It demarcates between the right and wrong,
2. It deals with the operating issues in an organization;
3. It relates to the corporate social responsibility;
4. It directs the organization to be good corporate citizens apart from being profitable;
5. It defines the descriptive (what is being done) as well as normative ethics (what should be done);
6. Though it is not legal but it is much larger than any law.

Let us see a hypothetical example where the organization is termed to be ethical. Organization ‘T’ is said to be one of the most ethical and socially responsible organization.

Q. What does it do to become an ethical organization?

Ans. It follows the following business activities:

- It makes the organization effective;
- It follows the concept of wealth maximization than profit maximization;
- It treats its customers as kings/queens,
- It builds a culture where the employees have a high level of integrity;
- It gives importance to the families of the employees;
- It deals with the ethical dilemmas in teams.

This example shows that business ethics is an integral part of strategic management as it helps in achieving the goals of the organization in the most ethical way.

Activity 1

Select an organization which follows ethics and list the business activities which make it ethical.

.....

.....

.....

11.4 PILLARS OF CORPORATE GOVERNANCE

Corporate governance is a combination of five pillars. The objectives of these pillars help an organization in the implementation of strategy. These pillars are:

1. Accountability
2. Fairness
3. Transparency
4. Integrity
5. Social responsibility

All these pillars are critical for the success of an organization. This helps in developing a strong relationship with the shareholders and all stakeholders.

1. **Accountability:** This is a form of ownership strategy which means owning the rewards and failures/risks in the context of the value proposition by an organization. Accountability should be applicable at all levels from the lower management to the top management, and then only it works.
2. **Fairness:** This means treating all the stakeholders equally without any demarcation of caste, status etc. This involves effective communication as well.
3. **Transparency:** This is one of the most important pillars of corporate governance as it gives credibility to an organization. Transparency means, disclosing all the information which are relevant and important for all the shareholders and stakeholders so that they are not in dark about the performance of an organization.
4. **Integrity:** It is important for any organization and this comes through a professional culture where each employee is given importance which makes him/her to perform at their best.
5. **Social responsibility:** This applies at the top management level. The decision taken at the top should be such that they benefit the organization as a whole. Therefore, it is important that the organization should have a clear understanding of these pillars and practice there accordingly.

Activity 2

Discuss as to how the five pillars of corporate governance help an organization achieve its objective.

.....

.....

.....

.....

.....

11.5 MODELS OF CORPORATE GOVERNANCE

There are seven basic models of corporate governance. These are:

1. Canadian Model
2. UK and American Model
3. German model
4. Italian model
5. France model
6. Japanese model
7. Indian model

We will discuss these models in brief:

1. **Canadian Model:** Canada is country which has a large influence of French culture. This is because it was a colony of France and Britain. Till 19th century, the industries in Canada were basically family businesses but for the past five decades the scenario has changed and now it resembles the US industry structure. Looking at its corporate governance structure it is visible that it was one of the early initiators of corporate governance.

2. UK and American model/ Anglo-American model

Sarbanes Oxley Act (SOX) was passed in July 2002 with the aim to provide more transparency and accountability to US corporate. This act focuses on the following:

- Re-establish investor confidence through good corporate governance practices;
- Improve accuracy and transparency in financial reporting;
- Accounting service of listed organizations;
- Increased corporate responsibility;
- Auditing independently;

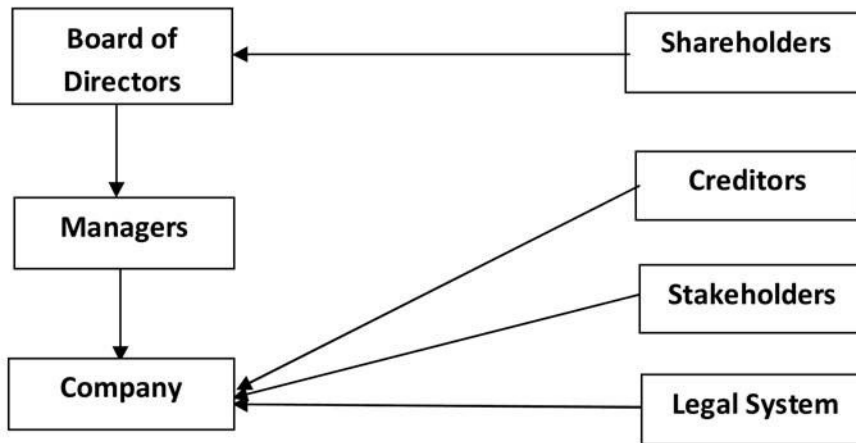


Figure 11.1: The Anglo-American Model

3. **German Model:** Since 19th century Germany is known as the hub of industrialization. For the past five decades Germany has been exporting sophisticated Machinery. The financing of the German industries is being done by rich German families, small shareholders, bankers and foreign investors. Since the second half of 19th century Germany has been taking steps towards corporate governance. The company law was introduced in 1870 and 1884 company law highlighted on making the information transparent. As of now Germany has more number of family controlled businesses. Figure 11.2 shows the German model of industry and corporate governance.

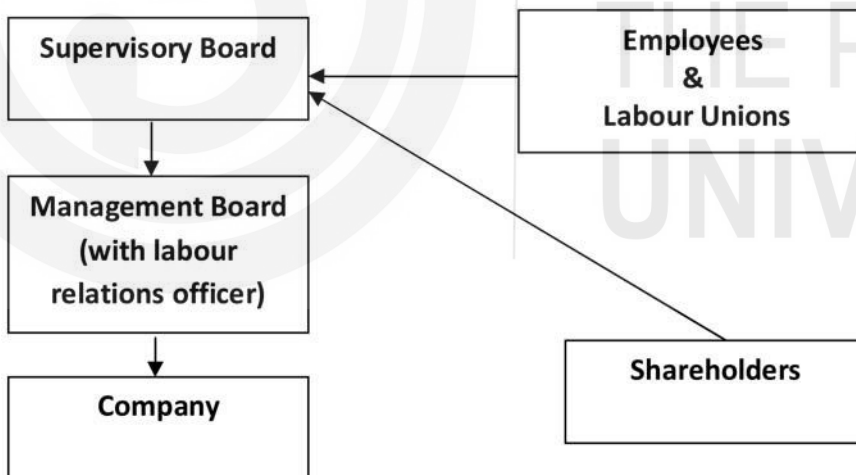


Figure 11.2: The German Model

4. **Italian Model:** Since a long time the Italian business has been dominated by the family holdings. This trend continued till the 20th century. In the second half of the 20th century, the stock market gained importance. In 1931 all the Italian investment banks collapsed which led to the fascist government taking over of all the industrial shares and imposing a legal separation of investment from the commercial banks since World War II, with the introduction of the Industrial policy with no need for investor protection. Since long the corporate governance lied with bureaucrats and rich families. In the last two decades, the corporate governance is in an organized form. Now the investors in Italy are aware of their rights and importance of corporate governance.

5. **France Model:** The financial system in France was controlled by religion and the state was the main borrower. The basic form of lending was mortgage and coins were the major part of money transaction. The French industry was based on a consecutive outlook. The corporate governance was introduced in France in a stage-wise manner with economic development activities.
6. **Japanese Model:** Japan has been a conservative country where the business families were at the bottom of the pyramid. This led to the stagnation of the businesses. After World War II the change in business took place and the entry of American traders was allowed. A new culture started building up and Japanese industry started gaining which was a mix of private and state capitalization. In the early 1930's during depression, the fall of family business started to take place and in 1945 the Americans took charge of Japanese economy. The concept of corporate governance evolved only in the past 20 years. Figure 11.3 shows the Japanese model of industry and corporate governance.

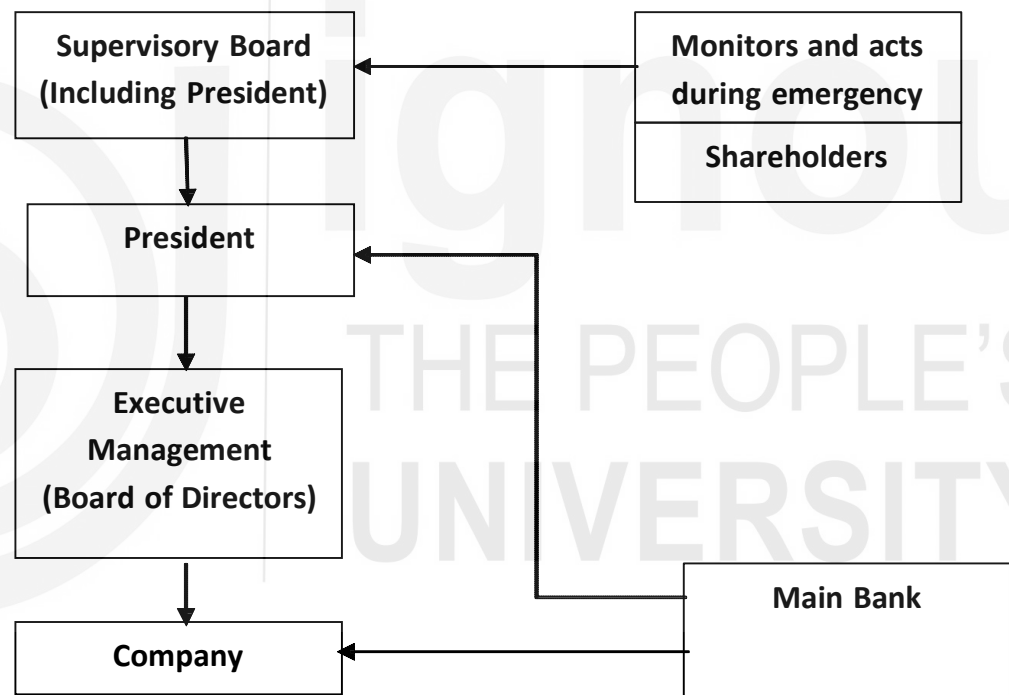


Figure 11.3: The Japanese Model

7. **Indian Model:** India has a long history of commercial activities. The formal structure of corporate governance was given by CII in 1998 which was termed as “Desirable corporate governance code”. In the year 2000, SEBI established a committee under the chairmanship of report Mr. Kumar Mangalam Birla to make the report. In the same year the ministry of finance set up Naresh Chandra committee which was supposed to examine the roles, duties and independence of auditors. In 2003 SEBI revised the clause 49 of listing agreement for listed companies based on the report of N.R. Narayanswami committee. The Indian model has mandatory compliance related to the BOD, audit committees, Subsidiary compliances relating to whistle Blower Policy, shareholders lights, and audit qualification and performance evaluation of board member.

List out the important provisions of the different models.

.....

.....

.....

.....

11.6 CORPORATE GOVERNANCE AND STRATEGY

As we have discussed earlier, it is quite visible that there is a strong relationship between corporate governance and strategy. Figure 11.4 describes the relationship of corporate governance with strategy. These are certain points which describe the relationship between the two. These are:

- Corporate governance when related to strategic management means the set of rules and policies of an organization;
- Corporate governance stresses the importance on stakeholders at large;
- It distinguishes between the roles of owners and the managers;
- It helps the organization in effective strategic decision making;
- It helps the organization in developing fairness towards its investors.

Overall corporate governance gives the direction to the organization so that it can perform effectively.

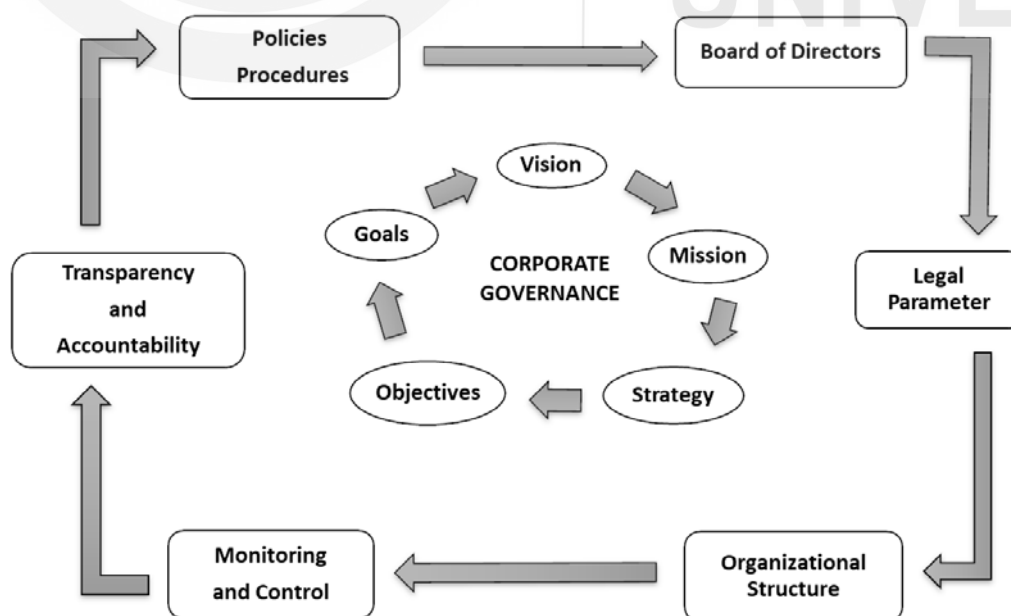


Figure 11.4: Corporate Governance and Strategy

11.7 CHALLENGES OF CORPORATE GOVERNANCE

Now we know that corporate governance is all about direction, management and control of an organization. However, there are many issues and challenges organizations face due to the uncertain situations. Pandemic has caused the organizations to slow down, which have created a kind of unrest in the organization. The issues and challenges of corporate governance can be listed as follows though this cannot be termed as exhaustive list:

1. **Board appointments:** This is the major issue as due to issues like pressure from promoters etc. the appointments of the board may be biased. The organizations need to be very careful while appointing the board as this may become a hindrance in the success of the organizations.
2. **Performance evaluation of Directors:** this is another challenge in implementing the corporate governance as there may be cases where the evaluation of the performance of the directors may not be allowed.
3. **Appointment of Independent Directors:** As per the code it is mandatory to appoint an Independent director but this appointment may be biased in many cases as the promoters/investors may pressurize the organization to appoint their own person. This unethical practice may act as a bottleneck for the success of the organization.
4. **Removal of Independent Directors:** The law says that the Independent directors can be removed anytime. This law at times may become a challenge for the organizations. In this case also the promoters/investors may put pressure to remove an independent director who does not take decisions in their favour.
5. **Accountability towards stakeholders:** This is a major challenge on part of the organizations. There may be various reasons where the organizations overlook the welfare of the stakeholders. There are number of examples globally where organizations have adopted unethical practices to make more profits.
6. **Role of promoters:** The role of promoters is very important for organizations. As discussed earlier, if the promoters look after their own interests only then it become a major challenge for the organizations.
7. **Transparency issues:** Many organizations get stuck into the quagmire of unethical practices which leads to transparency issues.
8. **Conflict in organization:** The conflict inside the organization creates a major challenge. If the conflict is not resolved then it is presumed that the organization may not succeed and will lead to ill practices like bribe etc.
9. **Level of mistrust:** If the organization loses its credibility then it is very difficult to build it again. Regaining the trust of stakeholders and shareholders becomes a major challenge.

It is very difficult to control the external environment but strong core values of any organization can help it in overcoming such challenges.

11.8 SUMMARY

In this unit we have discussed different aspects of corporate governance. The evolution of corporate governance dates back to third century BC. The main aim of corporate governance was to protect the interest of the society which later turned out to be protecting the interests of the stakeholders/shareholders. In the 20th century different models emerged and they were modified as per the needs. The United Kingdom, USA and Canada are termed to be the initiators of the formalization of corporate governance practices. In India Government, CII, SEBI and other regulators came out with various reports to formally implement the codes of corporate governance. All the experts throughout the globe believed that strengthening corporate governance is necessary as it bridges the gap between the corporate and its various stakeholders. This can be done by applying the five pillars of Corporate Governance. The unit also discusses the importance of business ethics in implementing Corporate Governance practices. It is not easy to implement corporate governance. Organizations throughout the globe are facing issues and challenges in implementing the same. Some challenges have been discussed although there may be many more depending on the structure of the organization. Overall the unit gives a bird's eye view about the concept of Corporate Governance.

11.9 KEY WORDS

Stakeholders	: Those who can affect or get affected by the business.
Shareholders	: is a person or organization who owns at least one share or the stock of the organization.
Corporate Governance	: It represents the values, ethics and the morals which business strategic decisions are made
Code of Ethics	: A document which outlines the mission and values of the organization.
Business Ethics	: It involves understanding the policies and procedures for appropriate action.
Strategy	: It is the plan of action of an organization.

11.10 SELF-ASSESSMENT QUESTIONS

- 1) Define Corporate Governance. Why is it important for organizations to follow corporate governance practices?
- 2) Describe different models of Corporate Governance.
- 3) Explain the concept of business ethics citing examples.
- 4) In the present context what are the major challenges that the corporate sector is facing regarding implementing Corporate Governance.
- 5) How can you relate Corporate Governance with Strategy? Discuss.

11.11 REFERENCES AND FURTHER READINGS

Bajpai, G. N. (2016). *The Essential Book of Corporate Governance*. India: SAGE Publications.

Das, S. C. (2018). *Corporate governance in India: An evaluation*. India: PHI Learning.

Fernando, A. C. (2018). *Corporate Governance: Principles, Policies and Practices* (3rd ed.). United States: Pearson India.

Minow, N. & Monks, R. A. G. (2011). *Corporate Governance*. United Kingdom: Wiley.

Sarkar, S. & Sarkar, J. (2012). *Corporate Governance in India*. India: SAGE Publications.



UNIT 12 CONTROL

Objectives

After studying this unit, you should be able to:

- Understand the strategic control process;
- Understand importance of strategic control in evaluation;
- Understand different methods used in control process; and
- Understand the analysis and follow-up action for control.

Structure

- 12.1 Introduction
- 12.2 Functional Strategies
- 12.3 Strategic Control Process
- 12.4 Operational Controls
- 12.5 Performance Standards
- 12.6 Analysis and Follow-up Action for Control
- 12.7 Problems of Control Systems
- 12.8 Types of Strategic Controls
- 12.9 Difference between Operational and Strategic Control
- 12.10 Summary
- 12.11 Key Words
- 12.12 Self-Assessment Questions
- 12.13 References and Further Readings

12.1 INTRODUCTION

With the completion of the strategy implementation, the organization looks forward to achieving the desired goals and objectives. It is necessary, however, to introduce the process of strategy evaluation and control in the early stages of implementation, to see whether the strategy is successful or not, and to carry out mid-course corrections wherever necessary. There are several reasons why a strategy may not lead to desired results. The external environment may not actually follow a trend as was expected at the time of planning the strategy. The internal changes within the organization such as the organizational systems consisting of structure, policies and procedures may not reflect harmony with the strategy. After a while, the top management of even middle-level managers may find it difficult to exercise a substantial degree of control over operating systems. The unexpected moves of the competitors might create major gaps in the strategy. Thus the list of such factors will require a continuous evaluation and control of strategy. In this unit we will describe the control process. Before we discuss the control process, it is very important to have an idea of functional strategies.

12.2 FUNCTIONAL STRATEGIES

The strategies have to be ultimately translated into business operations. The operating decisions are taken by middle and junior level managers. Functional policies provide guidelines to operating managers so that (a) the strategies are implemented (b) decisions are made effectively (c) similar situations are handled consistently, and (d) coordination across functional units takes place. Once the strategy of the organization is decided, modification in functional policies may become necessary to meet the demands of new business or new business philosophy, particularly if a major deviation in product/market scope is contemplated. This becomes all the more necessary in the Indian context where unrelated diversification is not uncommon and where large-scale sickness of business exists. Depending upon the changes in the present business and the method of its management, the magnitude of modifications may range from a few minor ones to total revamping of functional policies. For instance, an organization might plan an expansion in sales by introducing installment schemes. This may need some alteration in the financial policies. On the other hand, if an organization is growing only at a 5% rate wants to be the leader in the industry and has the ambition of appearing on world scene, major changes may be imperative not only in financial but also in technology production, marketing, personnel and R & D policies. The functional policies should be comprehensive; they should not leave so much choice to operating managers that they work sub optimally or at cross purposes. At the same time, the policies should be flexible enough to leave room to managers for responding quickly to situations and make exceptions for good reasons. The organization should have policies in every major aspect of business, at least in key functional areas.

In the financial management area, the major policies relate to the arrangement and deployment of funds. Major issues involved are the sources from where the funds will come, from owners (equity) or by borrowing. How much of the borrowing will be short-term and how much long-term? In terms of usage of funds, the policy decisions would relate to whether and to what extent funds have to be deployed in long-term (fixed) and short-term (current) assets. The long-term or capital investment decisions relate to buying or leasing the fixed assets. A retrenchment strategy or paucity of funds may compel the organization to lease rather than buy. In case of an organization where capital investment decisions are decentralized, a “hurdle rate” may be fixed so as to avoid investment in weaker projects by one division and non-investment by another division.

Apart from capital budgeting, another consideration in financial management which influences other functional areas is the cash flow. An organization may frame bonus and dividend policies based on availability of cash. In case an organization proposes expansion through internally generated funds, it may reduce bonus and dividend. This is particularly so when it has formulated ambitious growth policies which require huge cash. Similarly, if the organization has high risk business, it should have a conservative debt/ equity ratio to guard against falling in red due to heavy interest burden. The funds position and optimization orientation of top management also determine the accounts receivable and payable policies. Financial policies may even determine the account keeping (e.g. LIFO or FIFO) as these affect the profitability, balance sheet and hence cash flow through tax, dividend, bonus, etc.

Functional policies in marketing area are required for marketing-mix decisions, namely, the four Ps (Product design, Product distribution, Pricing and Promotion) of marketing. In terms of specifics, the product decisions relate to such issues as the variety of product/service (shape, size, models, etc.), completeness of the line, quality requirements, introduction/withdrawal of products, nature of customers, etc. Specific policies are also necessary regarding distribution channels, i.e., through retailers or direct selling? What will be the spread of distribution network? Whether new dealers will be established or old ones developed? What will be the terms of contract with dealers and the nature/extent of after-sale service (wherever necessary)? The promotion policies will relate to mode of promotion, coverage and nature (corporate/ product or brand promotion). Very clear and specific policies are to be made about pricing, e.g., full cost or standard cost based pricing. Offensive vs. defensive postures also influence pricing policies.

The functions relating to production will need policies relating to quality assurance, machine utilization, location of facilities, balancing the line, scheduling of production, and materials management. The strategy for entering into export market will dictate a different policy regarding quality of products and maintenance. In case of common facilities policies of prioritization will have to be made for scheduling production. Location of facilities may be determined by closeness to market or input supply points. Policies must be made to determine whether and how much to make or buy, on the basis of cost differential, certainty regarding availability, criticality of the item, ability to follow up procurement action for production, capacity utilization of the existing plant and facility and alternative uses of expanded capacity if expansion becomes necessary. In case of bought out items, policies regarding the number of suppliers and the criteria for selecting them are necessary.

In the area of research and development, functional policies regarding nature of research are necessary. In case of expansion through new product development, heavy emphasis has to be laid on basic and applied research. On the other hand, for expansion in the same line, research emphasis has to be on product/process improvement to cut cost and on added value. It may be noted that in case of basic research the organization should be prepared to commit resources and wait for outcome for several years. It cannot have basic research unless it is prepared to commit resources on long-term basis.

Lastly, functional policies will be necessary in the area of personnel management: what will be the compensation/incentive system to get the best out of the people and to make them fit for desired positions in the organization? What compensation/incentive system will be able to attract people of the desired type to join the organization so as to meet the task requirements demanded by the strategy? What policies will be necessary for grooming internal people for new positions? The problem becomes acute in the context of turnaround strategies. On the one hand, the most competent people leave and the organization finds it difficult to attract suitable replacements. On the other hand, it faces problem of surplus staff. Retrenchment policies, though painful, are quite necessary but difficult to develop.

The functional policies have a lot of interlinks between themselves and, therefore, cannot be developed independent of each other. Attempts to do so, for whatever reason, may lead to chaos and serious mismatches, resulting in failure of the strategy. This is the reason control is important.

Activity 1

List the main functional policies in your organization. What mismatch, if any, do you notice among them?

.....

.....

.....

.....

12.3 STRATEGIC CONTROL PROCESS

The evaluation of the strategy of an organization can be done qualitatively as well as quantitatively. The quantitative evaluation is based on data and is possible through post facto analysis to detect whether the content of strategy is working or has worked. However, qualitative evaluation can also be done by addressing the question: Will it work? The qualitative evaluation can thus be done before activating plans of change. The qualitative evaluation and control of strategy is a real time process. The performance of strategy is monitored and corrective actions are taken. The basic aim of any organization is to achieve its goals. But to achieve the goals, the organization faces lots of hurdles. To overcome these hurdles, it is necessary for any organization to have a sound strategic control process. The word meaning of 'control' itself means 'to regulate' or 'to check'. This means that the top management needs to keep check on how well the strategy is being implemented to achieve the objectives of the organization. For example, if the business is not giving results as expected, it may be necessary to increase promotional efforts, or revise the product policy, or as a last resort, the organization may pull out of a particular business.

The strategic control process is closely related to strategic planning process. The process consists of three phases, which are as follows: 1) Evaluation criteria; 2) Performance evaluation; and 3) Control methods.

The first phase i.e., the evaluation criteria consists of selecting the success factors, developing measures and setting standards for the same and collecting information about actual performance.

Quantitative criteria for evaluation: This is important for measuring the organizational performance whereby the actual results are compared with the expected results. Usually the organizations use financial ratios as quantitative criteria for evaluating strategies. These are used due to the following reasons:

- 1) To compare the performance of the organization over different time periods;
- 2) To compare the performance of the organization with its competitors in the industry;

- 3) To compare the organizations' performance to industry averages.

Some of the major financial ratios which can be used as criteria for evaluation of strategy are:

- 1) Return on investment
- 2) Return on equity
- 3) Profit margin
- 4) Market share
- 5) Debt to equity
- 6) Earnings per share
- 7) Sales growth
- 8) Asset growth

These ratios are used by different organizations to measure the performance of the organization. Here, one thing is to be noted that the qualitative criteria are related more to the short-term objectives than the long-term ones. This is the reason why qualitative criteria are very important in evaluating strategies. Therefore, to evaluate strategies certain qualitative questions should also be taken into consideration. These questions can be:

- Whether the strategy is internally consistent or not?
- Whether it is appropriate considering the available resources or not?
- How is the organization balancing its investments between high-risk and low-risk prospects?

This shows that answers to all these qualitative questions are important to evaluate and control the strategy.

12.4 OPERATIONAL CONTROLS

There are several types of operational controls such as financial controls, budgeting, management by objectives and time controls. Now let us discuss these in detail.

Financial controls

There are many methods/techniques used in strategic control systems. Every organization has its own way of using a particular technique according to the requirement of the organization. Most of the methods related to the strategic management are regarding the financial control systems. Figure 12.1 shows one of the effective systems of financial control, which is universally accepted and is used by many organizations throughout the world. This system of financial control is known as DuPont's system of financial control.

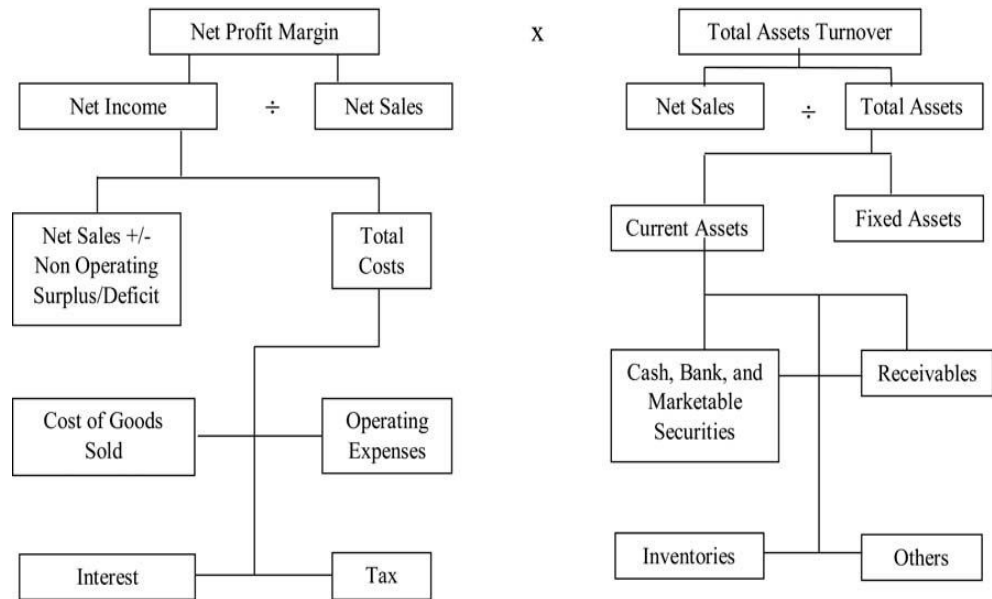


Figure 12.1: DuPont Chart

Source: Adapted from Chandra, Prasanna (2006)

The other methods which are used most frequently are: Budgets, Audits, time-related control techniques like: PERT and CPM, Management by Objectives (MBO). We will discuss these methods in brief to develop an understanding of the Strategic Control Process.

The accounting ratios play an important role in the evaluation and control of financial strategy of the organization. The purpose of each accounting ratio is different. Table 12.1 gives a brief idea about the reasons for use of accounting ratios though this is not an exhaustive list.

Table 12.1: Classification of Accounting Ratios based on intention

S. No.	Intention	Associated parties	Ratios
1	Profitability of the organization	Stakeholders, shareholders, bidders, lenders, competitors	• Profit to capital ratio • Gross profit to sales • Net profit to sales • Cost to cost of sales
2	Liquidity position (short term and long term)	Lenders including banks, short term creditors	• Current assets to current liabilities • Quick assets to quick liabilities • Working capital to current assets • Stock to current assets • Short term resources to current assets • Liquid ratio

3	Solvency position	Shareholders, banks, long term creditors etc.	• Debt to total assets • Debt service coverage • Interest coverage
4	Asset utilization	Shareholders, competitors, potential bidders	• Fixed assets to capital • Net sales to capital
5	Capital structure	Shareholders, competitors, potential bidders	• Net worth to total assets • Fixed assets to net worth
6	Market structure	Shareholders, competitors, potential bidders	• Earnings per share • Price Earnings • Dividend yield • Market Capital
7	Managerial capability	Shareholders, competitors, potential bidders	• Profit to sales • Debtor's turnover • Creditors 'turnover • Debt-Equity ratio

Budgets

Budgets are one of the most widely used control methods .Budget means ‘a plan of income and expenditure’. It usually deals with allocation of resources to different organizational units. Table 12.2 shows an example of a budget report. Budget gives an idea about the future expenditures and income and at this juncture only the analysis of the performance of the organization is done and corrective action can be taken up for flaws, if any. Since budget is actually a forecast, its revision would be required from time to time depending upon the requirement of the organization. It is one of the key elements in implementing the strategy successfully.

Table 12.2: Budget Report

June 5 Months (year-to-date)							
Budget	Actual	Difference	%	Budget	Actual	Difference	%
Total cost (₹)	40,000	50,000	10,000	+25	20,00,00	20,50,00	5,000+25
Total Units produced	10,00,000	12,00,000	20,00,00	+20	1,000,0000	1,000,0000	+0%

Budgets can be classified on the basis of time, monetary unit, function, flexibility.

Table 12.3 gives a brief idea of the types of budgets used as a control tool.

Table 12.3: Classification of budgets

S. No.	Category of classification	Type of budget	Expression
1	Time	• Long term budget • Short term budget • Fiscal budget	• Up to five years • Weekly, monthly or yearly • Current year
2	Monetary unit	• Financial budgets • Non-financial budgets	• Wages, overheads, sales, capital expenditure etc. • Materials, manpower, production etc.
3	Functional	• Sales budget • Production budget • Personnel budget • Purchase budget • Capital expenditure budget	• Forecast of total sales • Forecast of the production • Forecast of planned cost on direct and indirect labour • Purchases to be made • Planned outlay of fixed assets
4	Flexibility	• Fixed budget • Flexible budget	• Fixed plan of activity • Flexible activity

Audits

This is another method of control. As per American Accounting Association (AAA), auditing is defined as “a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users” (Byars, 1987).

Audit functions come under three basic groups. These are:

- Independent auditors
- Government auditors
- Internal auditors

Independent auditors are professionals who provide their services to the organization.

Government auditors: This precludes the agencies who perform government audits for organizations.

Internal auditors are employees within the organization and perform their function from within.

There is one more group known as Management Audit, which examines and evaluates the overall performance of all organization’s management team. Audit teams assess the efficiency of various units in the organization and the control system of the organization. The information provided by them becomes crucial

for the management. Nowadays most of the organization go in for management audits.

Time-related Control Methods

This includes useful graphical and analytical methods and these methods serve as a tool in the strategic control process. The most popular methods include Critical Path Method (CPM) and Programme Evaluation and Review Technique (PERT). These are graphical network depicting the different segments of work that must be completed within a given span of time to complete a project or task. These provide information for both project planning and control and are helpful for the management in allocating its limited resources.

Management by Objectives (MBO)

This is one of the methods, which is used both in strategic planning and control. In this the objectives are established for the organization as a whole for functional areas, departments and finally individuals of the organization. It has three minimum requirements which are as follows:

- 1) Objectives for individuals.
- 2) Individuals are evaluated and receive feedback on their performance.
- 3) Individuals are evaluated and rewarded on the basis of their performance.

This helps in keeping a check on working of employees in the organization and helps achieve the goals of the organization. Apart from these control methods, other methods like: Management Information Systems (MIS) and Decision Support Systems (DSS) also can be included under the control methods.

Activity 2

Suppose you are a financial expert working for a bank. Identify the key financial ratios important to evaluate the strategy of the bank.

.....

.....

.....

.....

12.5 PERFORMANCE STANDARDS

Having identified the measures relevant for assessing the success of the strategy, the next important issue is to set the standards against which actual performance which is to be measured. The standards of performance could be any of the following three types.

a) Historical Standards

In this type, comparison of present performance is made with the past performance. Though it is the simplest of all, this type does not take into account the changes in environmental conditions between the two periods. Moreover,

the prior-period performance itself may not have been acceptable. It could also be misleading in the formative years when the numerator (previous year's figures) is small.

b) Industry Standards

In this type of standard, the comparison of an organization's performance is made against similar other organizations in the industry. The difficulty here is that all the organizations may not be exactly the same for purpose of comparison.

c) Present Standards

The goals/targets are decided by the organization's management to be achieved in a particular period. Present standards convey the aspiration levels and take into account environmental conditions, if properly derived. These are more realistic and also consider the organizations' capacity to achieve them. These, however, require tremendous analysis. Absence of such analysis may lead to shocking results. However, for a organization developing a conscious strategy, present standards provide the best alternative.

Activity 3

What kinds of standards are being used in your organization? What in your view, are the problems arising out of it?

.....

.....

.....

.....

12.6 ANALYSIS AND FOLLOW-UP ACTION FOR CONTROL

Once the actual operations start, information about the actual performance has to be collected periodically and compared with the standards set. If the objectives or major components of strategy include such factors as market leadership, information about market share will also have to be collected. Information may also be collected regarding performance of the other key factors. If the performance on key success factors is unsatisfactory, the long-term success of the strategy may be endangered. This may be despite the current success which may be due to favourable current environment. For example, boom in the industry, scarcity etc.

If the performance is unsatisfactory, two courses of action are possible. The responsibility centre manager may be asked to improve performance, or if it is not possible, target or standards of performance may be revised. The evaluation and control reports may be of two types namely; the motivational and the economic reports. The motivational reports relate to the performance of the people in the responsibility centres. Economic reports are concerned with the economic performance of the responsibility centres. The basic difference in the two is that while the latter gives actual economic performance covering all factors, the former

reports the performance of a responsibility centre. For instance, while an economic report will include all costs, the motivational report will include only those items of cost over which it has control.

For example, the division may not have any control over purchase price of materials, but it may; have control over material consumption. Similarly, the responsibility centre has control over market share while it may not have control over industry volume. It is advisable to keep the two reports separate. For instance, if the economic performance is going down despite best efforts of the responsibility centre, there may be a need to make a shift in the strategy. Similarly, strategic performance based on economic reports may be satisfactory but still there may be need for modification of the strategy if the good performance is due to unexpected favourable developments.

From the control point of view the reports must be timely; otherwise corrective action may not be possible. The frequency of reports is determined by the lead time required for corrective action and is constrained by the lead time for processing the transactional data and its transmittal to retrieve data in the form of reports. If on the other hand, the evaluations are made too early kneejerk reactions are likely which may hurt the plan.

A strategy need not be changed or abandoned just because evaluation has revealed the causes of poor performance over a short period. It should be tested for a sufficiently long period of time because certain assumptions might have gone wrong and there was no contingency plan to take care of such situations. If even after reasonable period of time the performance is not coming up to expectations, it may be due to serious deficiencies in the business strategy. However, before changing the strategy, it would be advisable to check its implementation on the test of adequacy. And, if corrected, the strategy may still be quite useful. However, there might have been serious errors in assessing the external and internal environments even though the evaluation of implementation reveals no major mismatches.

Activity 4

How are the targets fixed for various divisions/departments in any organization? How and why are the targets revised? Give comments on the duration of target fixing and revising.

.....

.....

.....

.....

12.7 PROBLEMS OF CONTROL SYSTEMS

‘There are a large number of problems associated with control systems for strategy evaluation. An efficient system may collect a lot of irrelevant data whereas a

sophisticated system might ignore crucial information. Some of the typical problems encountered in designing and managing control system are:

- There may not be a consensus on the criteria for measuring the effectiveness and efficiency of the strategy.
- The reporting data may be invalid.
- The performance norms may be based on outputs on which the relevant business may not have a control.
- Often performance standards may be set with inherent contradictions. For example, an increase in market share may be expected in conjunction with an absolute decrease in marketing expenditure.
- Employees may consider the system to be unfair and therefore may not accept it.
- Overemphasis on measuring short-term performance may make managers forget about the strategy which inherently has long connotations.
- It is very difficult to set “good”, “average” and “poor” levels of performance in situations where the outputs are not very tangible.

12.8 TYPES OF STRATEGIC CONTROLS

Strategic control is a term that describes the process by which organizations control the formation and implementation of the strategies; it is a highly specialized form of management control that distinguishes from the other forms of control systems, especially operational controls. It deals with uncertainties at various points throughout the control process.

There are four types of strategic controls which are described below:

- Premise Control:** Every strategy is founded on certain planning premises or assumptions. Premise control is intended to examine whether the premises on which a strategy is based are still valid in a systematic and continuous manner. If you learn that a critical premise is no longer valid, you may need to rethink your strategy. The earlier you identify and reject an incorrect premise, the better. This is due to the strategy's ability to be altered to match reality.
- Special Alert Control:** A particular alert control is the rigorous and quick reconsideration of an organization's plan in response to an instant, unanticipated incident. An acquisition of your competition by an outsider is an example of such an occurrence. Such an occurrence will result in an urgent and thorough rethinking of the organization's strategy. Create crisis management teams to handle your organization's early response to unanticipated situations.
- Implementation Control:** Implementation of a strategy entails a sequence of processes, activities, investments, and acts that take place over time. As a manager, you will mobilize resources, complete special initiatives, and hire or reassign employees. Implementation control is a

sort of strategic control that must be implemented as events develop. Strategic thrusts or projects and milestone reviews are the two forms of implementation controls. Strategic thrusts give information that may be used to assess if the overall strategy is progressing as expected. With milestone reviews, you may track the strategy's success at regular intervals or milestones.

- d) Strategic Surveillance:** Strategic surveillance is intended to monitor a wide variety of events both within and outside your organization that are likely to have an impact on the direction of your business's strategy. It is founded on the premise that by monitoring several information sources, you might find significant yet unexpected information. Trade periodicals, journals, trade conferences, talks, and observations are examples of such sources.

12.9 DIFFERENCE BETWEEN OPERATIONAL AND STRATEGIC CONTROL

We have seen how Operational control and Strategic control play an important role in implementation of the strategy. Let us now learn the basic difference between the two as shown in table 12.4.

Table 12.4: Classification of budgets

S. No.	Basis of difference	Operational Control	Strategic Control
1	Nature	Routine operations as per the goal of the organization	Formulation and implementation of strategy
2	Control	Feedback	Feed forward
3	Management level	Functional level	Top level
4	Orientation	Action oriented	Futuristic
5	Direction	Monitors the efficiency levels	Monitors whether the organization is aligned with the goals and objectives or not
6	Environment	Internal	External
7	Aim	Efficiency	Effectiveness
8	Time period	Short-term	Long-term
9	Focus	Individual tasks	Strategic Management Process

To summarize it can be said that operational control as well as strategic control go hand in hand.

12.10 SUMMARY

An effective system of evaluation and control is important for the success of corporate strategy. It is also necessary for taking decisions on whether strategy should be continued or modified. The success of a strategy should be considered both in terms of effectiveness and efficiency. While it is easy to measure efficiency, it is relatively more difficult to measure effectiveness.

The problem in evaluation and control is that of developing appropriate measures. The key variables of the organization may guide the duration of measures for evaluation and control. Structure also plays an important role in evaluation and control of strategy. Defective structures may lead to inadequate evaluation and control. The economic performance of an organization must be distinguished from the performance of people of the unit from the viewpoint of follow-up action. Factors which are not under the control of a responsibility centre must be excluded from the reports in evaluating the performance of the responsibility centre people. For evaluation of a strategy or concrete action, all factors of cost and environment must be included. On the basis of evaluation the corrective action may be taken if the performance is not up to the planned levels. If it is found that the performance of the responsibility centre is not improving or is unlikely to improve, the targets may be revised.

If there are successive failures, the strategy may have to be abandoned. Before abandoning the strategy, however, an examination should be made as to whether implementation has been adequate.

12.11 KEYWORDS

Control : To regulate.

Performance Standards : Standards against which actual performance is to be measured.

Ratio Analysis : The principal tool of financial statement analysis.

12.12 SELF-ASSESSMENT QUESTIONS

- 1) Compare and contrast different types of standards which can be used for control of strategy.
- 2) Discuss the strategic control process.
- 3) Briefly explain some areas in which organizations establish quantitative evaluation criteria.
- 4) What can be the characteristics of an effective control system? Discuss.

12.13 REFERENCES AND FURTHER READINGS

Anthony, R. N. & Govindarajan, V. (2014). *Management Control Systems*. United Kingdom: McGraw-Hill Education.

Arora, M. N. (2016). *Cost and Management Accounting*. India: Himalaya Publishing House.

Banerjee, B. (2017). *Financial Policy and Management Accounting*(9th ed). New Delhi: PHI learning private limited.

Byars, Lloyd. (1987). *Strategic Management: Planning and Implementation, Concepts and Cases*.New York: Harper & Row Publishers.

Chandra, Prasanna. (2020). *Fundamental of Financial Management*(7th Ed.). India: Tata McGraw- Hill Education.

Das, S. C. (2011). *Management Control Systems: Principles and Practice*. India: Prentice Hall India Pvt., Limited.

David, F. R. &David, F. R. (2017). *Strategic Management: A Competitive Advantage Approach, Concepts and Cases*. United Kingdom: Pearson.

Kishor, R. M. (2016). *Strategic Management* (2015 ed.). Delhi: Taxmann publication.



ignou
THE PEOPLE'S
UNIVERSITY

UNIT 13 EVALUATION

Objectives

After going through this unit, you should be able to:

- Understand the process of evaluation;
- Discuss the aspects of business portfolio analyses;
- Understand the importance of qualitative measures used for evaluation;
- Understand the concept of balanced score card; and
- Discuss the characteristics of an effective evaluation system.

Structure

13.1 Introduction

13.2 Process of Evaluation

13.3 Business Portfolio Analysis

13.4 Qualitative Factors

13.5 Balanced Score Card (BSC)

13.6 Structure of Evaluation

13.7 Evaluation System in a Multi-business Organization

13.8 Characteristics of an Effective Evaluation Strategy

13.9 Summary

13.10 Keywords

13.11 Self-Assessment Questions

13.12 References and Further Readings

13.1 INTRODUCTION

Strategy evaluation is the last stage of the strategic management process and comes after strategy formulation and implementation as shown below.



An organization can have one of the best formulated and implemented strategies but if the evaluation of these is not done, they become obsolete over a period of time. Therefore, it becomes important to have an effective evaluation system so

as to help the organization to achieve its objectives. The evaluation process involves the control mechanism, which helps in taking corrective actions. We have already discussed the control process. In this unit, we are going to discuss the qualitative aspects and the portfolio analysis so as to develop a complete understanding of evaluation and control.

13.2 PROCESS OF EVALUATION

The key to a successful strategy is the effective implementation and evaluation system. Any kind of error in the strategic decisions will harm the organization, which in the long-run may be highly dangerous. Therefore, it is very necessary for the management to have a continuous evaluation system based on which the corrective actions may be taken. Figure 13.1 shows the process of evaluation.

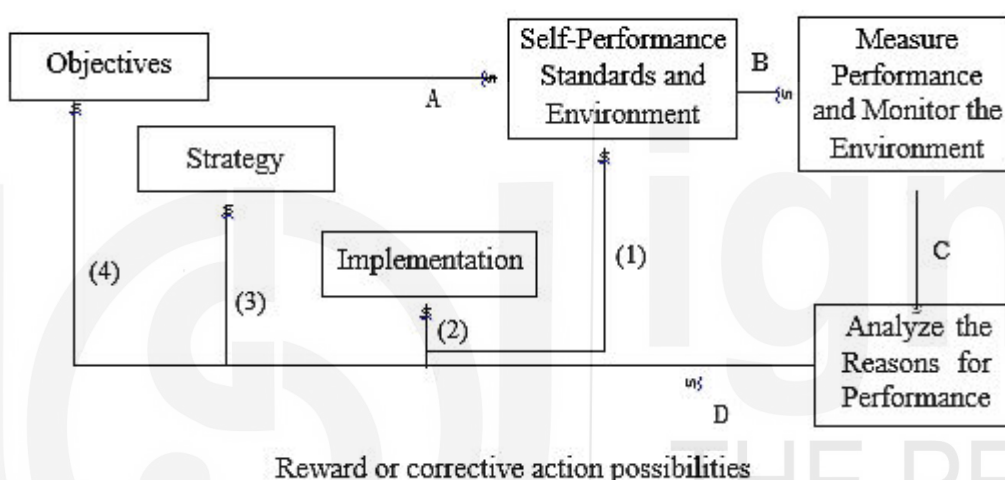


Figure 13.1: Evaluation of Strategy

The first phase of this process consists of selecting the key success factors, developing measures and setting standards for the same, and collecting information about actual state (performance on these measures). The second phase consists of comparison with the standards laid down and initiating action to alter performance, wherever necessary. The follow up action could relate to people/business or both and could be tactical or strategic. For instance, if the business has not picked up as expected, it may be necessary to increase promotional efforts, or revise the product policy, or as a last resort, the organization may pull out of a particular business.

It is necessary to maintain a distinction between the follow up action towards business/people and evaluation/control process. If major changes in environment have taken place and if major assumptions about environment have gone wrong, it may be improper to give credit or discredit to the people for the deviation in performance from standard set. At the same time good performance of a strategy may not be due to good performance of the people as there may be windfall gains due to changes in the environment not imagined at the time of setting the standards of performance or targets.

From figure 13.1 it can be realized that the process of evaluation is quite complex and there are several pitfalls in proper evaluation and control. The success of an organization is gauged by its effectiveness and efficiency. Effectiveness is

measured by the degree to which the organization has achieved its objectives while efficiency refers to the manner of resource utilization for achieving the output. The two can thus be represented as below:

a) $\text{Effectiveness} = \frac{\text{Output}}{\text{Objectives}}$

b) $\text{Efficiency} = \frac{\text{Output}}{\text{Input}}$

It is easy to evaluate efficiency by comparing output/input of various organizations or organization units with one another. Inputs, by and large, are always quantifiable. An organization is more efficient than the other if it uses fewer resources (inputs) than another, the same output or if for the same input it gives more output. The latter case requires output to be measured in quantitative terms and hence is more difficult to assess.

Measurement of effectiveness has both numerator and denominator which are comparatively more difficult to quantify. Hence assessment of effectiveness is more difficult than the assessment of efficiency of the organization. The success of corporate strategy should be evaluated both in terms of efficiency and effectiveness. It is, however, not common to find an efficient but ineffective organization or vice versa.

In a profit oriented organization, profit becomes a surrogate measure for both efficiency as well as effectiveness. Profit is the difference between revenue and expense, and thus is a measure of efficiency. Being the objective itself, profit also becomes a measure of effectiveness. In organizations with multiple objectives, the situation is different if the surrogate measures like profit are not available/not sufficient for evaluating the strategy. In such cases the major problem in evaluating the strategy is to develop measures for evaluating the strategy. The problem is solved by identifying the key variables or key success factors which are measures of performance of certain key activities of the organization.

Activity 1

Analyze the periodical evaluation reports in any organization. Do they emphasize effectiveness or efficiency?

.....

.....

.....

.....

.....

.....

13.3 BUSINESS PORTFOLIO ANALYSIS

Portfolio analysis is an analysis of the corporation as a portfolio of different business with the objective of managing it for returns on its resources. The business may be in the forms of organizational units, such as different subsidiaries or divisions of a parent organization or Strategic Business Units (SBUs). Thus, portfolio analysis looks at the corporate investments in different products or

industries under the common corporate jurisdiction. The corporate manager analyzes the future implications of their present resource allocations and continuously evaluates which operations or products to expand or add, and which ones to be curtailed or disposed off, so that the overall portfolio balance is maintained or improved. The focus is on the present as well as the future.

The activities of an organization and its effectiveness in the market place also depend on what the other competing companies are doing. Therefore, the portfolio analysis takes into consideration such aspects as the organization's competitive strengths, resource allocation pattern and the industry characteristics. Portfolio analysis is primarily concerned with the balancing of the organization's investments in different products or industries and is useful for highly diversified multi-product companies operating in a limited market. The different subsidiaries or strategic business units have to be balanced with respect to the three basic aspects of running the business:

- Net Cash Flow
- State of Development
- Risk

Portfolio analysis is one of the methods to assist managers in evaluating the strategy. Let us now discuss different types of Business Portfolio Analyzes.

Display Matrices

The purpose of this analysis is to optimally allocate resources for the best total return, with focus on the corporate strategies. Many different approaches involving different display matrices have evolved over the years, with the common objective of successful diversification. Some of the common display matrices are:

- BCG's Growth-share Matrix
- McKinsey Matrix
- Strategic Planning Institute's Matrix
- Arthur D. Little Organization's Matrix
- Hofer's Product/Market Evolution Matrix

BCG's Growth-Share Matrix

BCG's Portfolio Analysis is based on the premise that majority of the companies carry out multiple business activities in a number of different product-market segments. Together these different businesses form the Business Portfolio which can be characterized by two parameters:

- 1) organization's relative market share for the business, representing the organizations competitive positions; and
- 2) the overall growth rate of that business.

The BCG model proposes that for each business activity within the corporate portfolio, a separate strategy must be developed depending on its location in a two- by-two portfolio matrix of high and low segments on each of the above mentioned axes.

Relative Market Share is stressed on the assumption that the relative competitive position of the organization would determine the rate at which the business

generates cash. An organization with a higher relative share of the market compared to its competitors will have higher profit margins and therefore higher cash flows. Relative Market Share is defined as the market share of the relevant business divided by the market share of its largest competitor. Thus, if Organization X has 10 per cent, Organization Y has 20 per cent, and Organization Z has 60 per cent share of the market, then X's Relative Market Share is $1/6$, Y's Relative Market Share is $1/3$, and Z's Relative Market Share $60/20 = 3$. Organization Z has Organization Y as its leading competitor, whereas Companies X and Y have Organization Z as their lead competitor.

The selection of the **Rate of Growth** of the associated industry is based on the understanding that an industrial segment with high growth rate would facilitate expansion of the operations of the participating organization. It will also be relatively easier for the organization to increase its market share, and have profitable investment opportunities. High growth rate business provides opportunities to plough back earned cash into the business and further enhance the return on investment. The fast growing business, however, demands more cash to finance its growth. If an industrial sector is not growing, it would be more difficult for the participating organization to have profitable investments in that sector. In a slow growth business, increase in the market share of a organization would generally come from corresponding reduction in the competitors' market share.

The BCG matrix classifies the business activities along the vertical axis according to the 'Business Growth Rate' (meaning growth of the market for the product), and the 'Relative Market Share' along the horizontal axis. The two axes are divided into Low and High sectors, so that the BCG matrix is divided into four quadrants (refer to Figure 13.2). Businesses falling into each of these quadrants are classified with broadly different strategic categories, as explained below:

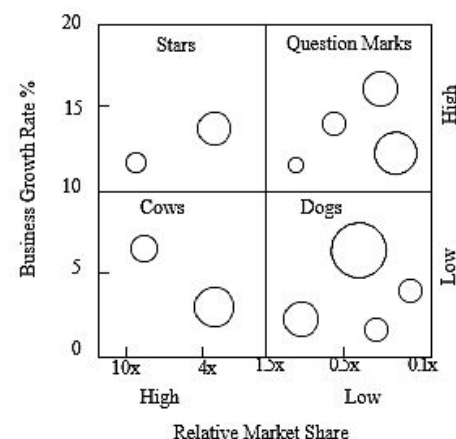
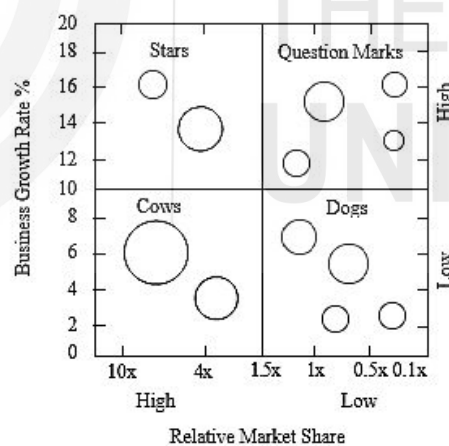


Figure 13.2: BCG Matrix

Cash Cows

The businesses with low growth rate and high market share are classified in this quadrant. High market share leads to high generation of cash and profits. The low rate of growth of the business implies that the cash demand for the business would be low. Thus, Cash Cows normally generate large cash surpluses. Cows can be 'milked' for cash to help to provide cash required for running other diverse operations of the organization. Cash Cows provide the financial base for the organization. These businesses have superior market position and invariably low costs. But, in terms of their future potential, one must keep in mind that these are mature businesses with low growth rate.

Dogs

If the business growth rate is low and the organization's relative market share is also low, the business is classified as DOG. The low market share normally also means poor profits. As the growth rate is also low, attempts to increase market share would demand prohibitive investments. Thus, the cash required to maintain a competitive position often exceeds the cash generated, and there is a net negative cash flow. Under such circumstances, the strategic solution is to either liquidate, or if possible harvest or divest the DOG business.

Question Marks

Like Dogs, Question Marks are businesses with low market share but the businesses have a high growth rate. Because of their high growth, the cash requirement is high, but due to their low market share, the cash generated is also low. As the business growth rate is high, one strategic option is to invest more to gain market share, pushing from low share to high. The Question Mark business then moves to a STAR (discussed later) quadrant, and subsequently has the potential to become cash low, when the business growth rate reduces to a lower level.

Another strategic option is when the organization cannot improve its low competitive position (represented by low market share). The management may then decide to divest the Question Mark business. These businesses are called Question Marks because they raise the question as to whether more money should be invested in them to improve their relative market share and profitability, or they should be divested and dropped from the portfolio.

Stars

Businesses which have high growth rate and high market share, are called Stars. Such businesses generate as well as use large amounts of cash. The Stars generate high profits and represent the best investment opportunities for growth. The best strategy regarding Stars is to make the necessary investments and consolidate the organization's high relative competitive position.

Methodology for Building BCG Matrix

The Boston Consulting Group suggests the following step-by-step procedure to develop the business portfolio matrix and identify the appropriate strategies for different businesses.

- Classify various activities of the organization into different business segments or Strategic Business Units (SBUs).
- For each business segment determine the growth rate of the market. This is later plotted on a linear scale.
- Compile the assets employed for each business segment and determine the relative size of the business within the organization.
- Estimate the relative market shares for the different business segments. This is generally plotted on a logarithmic scale.
- Plot the position of each business on a matrix of business growth rate and relative market share.

Strategic Implications

Most companies will have different segments scattered across the four quadrants of BCG matrix, corresponding to Cash Cow, Dog, Question Mark and Star businesses. The general strategy of an organization with diverse portfolio is to maintain its competitive position in the Cash Cows, but avoid over-investing. The surplus cash generated by Cash Cows should be invested first in Star businesses, if they are not self-sufficient, to maintain their relative competitive position. Any surplus cash left with the organization may be used for selected Question Mark businesses to gain market share for them. Those businesses with low market share, and which cannot adequately be funded, may be considered for divestment. The Dogs are generally considered as the weak segments of the organization with limited or new investments allocated to them.

The BCG Growth-share matrix links the industry growth characteristic with the organization's competitive strength (market share), and develops a visual display of the organization's market involvement, thereby indirectly indicating current resource deployment. (The sales to asset ratio are generally stable over time across industries). The underlying logic is that investment is required for growth while maintaining or building market share. But, while doing so, a strong competitive business in an industry with low growth rate will provide surplus cash for deployment elsewhere in the Corporation. Thus, growth uses cash whereas market competitive strength is a potential source of cash. In terms of BCG classification, the cash position of various types of businesses can be visualized as in Table 13.1

Table 13.1: Cash Positions of Various Businesses

<i>Sl. No.</i>	<i>Business Type</i>	<i>Cash Source</i>	<i>Cash Use</i>	<i>Net Cash Balance</i>
1.	COW	More	Less	Funds available, so milk &
2.	STAR	More	More	Build competitive position and grow
3.	DOG	Less	More	Divest and redeploy proceeds
4.	QUESTION	Less	More	Funds needed to invests electively to improve competitive position

Limitations of BCG Matrix

The Growth-share BCG Matrix has certain limitations and weak points which must be kept in mind while using portfolio analysis for developing strategic alternatives. These are discussed below:

Predicting Profitability from Growth and Market Share

BCG analysis assumes that profits depend on growth and market share. The attractiveness of an industry may be different from its simple growth rate, and the organization's competitive position may not be reflected in its market share.

Some other sophisticated approaches have been evolved to overcome such limitations. There have been specific research studies which illustrate that the well-managed Dog businesses can also become good cash generators. These organizations relying on high-quality goods, with medium pricing and judicious expenditure on R& D and marketing, can still provide impressive return on investment of above 20 per cent.

Difficulty in Determining Market Share

There is a heavy dependence on the market share of a business as an indicator of its competitive strength. The calculation of market share is strongly influenced by the way the business activity and the total market are defined. For instance, the market for helicopters may encompass all types of helicopters, or only heavy helicopters or only heavy military helicopters. Furthermore, from geographical point of view the market may be defined on worldwide, national or even regional bases. In case of complex and interdependent industries, it may also be quite difficult to determine the market share based on the sales turnover of the final product only.

No Consideration for Experience Curve Synergy

In the BCG approach, businesses in each of the different quadrants are viewed independently for strategic purposes. Thus, Dogs are to be liquidated or divested. But, within the framework of the overall corporation, useful experiences and skills can be acquired by operating low-profit Dog businesses which may help in lowering the costs of Star or Cash Cow businesses. And this may contribute to higher corporate profits.

Disregard for Human Aspect

The BCG analysis, while considering different businesses does not take into consideration the human aspects of running an organization. Cash generated within a business unit may come to be symbolically associated with the power of the concerned manager. As such managing a Cash Cow business may be reluctant to part with the surplus cash generated by his unit. Similarly, the workers of a Dog business which has been decided to be divested may react strongly against changes in the ownership. They may deem the divestiture as a threat to their livelihood or security. Thus, BCG analysis could throw up strategic options which may or may not be easy to implement.

BCG Modifications

It was in 1981 that the Boston Consulting Group realized the limitations of equating market share with the competitive strength of the organization. They have admitted that the calculation of market share is strongly influenced by the

way business activity and the total market domain are defined. A broadly defined market will give lower market share, whereas a narrow market definition will result in higher market share resulting in the organization as the leader. It was, therefore, recommended that products should be regrouped according to the manufacturing process to highlight the economies of scale manufacturing, instead of stressing the market leadership.

On the other hand, BCG still maintains that for branded goods it is important to be the market leader so that the advantages of economies of scale and price leadership can be fully utilized. But they also concede that such advantages may still be achieved even if the organization is not the largest producer in the industry. Some other versions of portfolio analysis have however developed much beyond these minor modifications of BCG analysis.

Activity 2

Consider an organization with which you are familiar. Collect information regarding its various businesses and describe them using the BCG growth-share matrix. First give the chronology of year-wise business development and then the matrix.

.....

.....

.....

.....

.....

.....

GE's Strategic Business Planning Grid

General Electric (or McKinsey) matrix uses market attractiveness as not merely the growth rate of sales of the product, but as a compound variable dependent on different factors influencing the future profitability of the business sector. These different factors are either subjectively judged or objectively computed on the basis of certain weightages, to arrive at the Industry Attractiveness Index. The Index is thus based on a thorough environmental assessment influencing the sector's profitability.

Factors determining Industry Attractiveness:

	Typical weightage
1) Size of market	10%
2) Rate of growth of sales and cyclic nature of business	15%
3) Nature of competition including vulnerability to foreign competition	15%
4) Susceptibility to technological obsolescence and new products	10%
5) Entry conditions and social factors	10%
6) Profitability	40%
	100%

Against each of these factors, the concerned business is rated on a scale of 1 to 10, and then the weighted score is determined from a maximum of 10. This gives the Industry Attractiveness Index for the business under consideration.

Factors determining competitive position of the organization as with industry attractiveness, the competitive position of the organization is analyzed not only in terms of organization's market share, but also in terms of other factors often appearing in the Strength and Weakness analysis of the organization. Thus, product quality, technological and managerial excellence, industrial relations etc. are also incorporated besides market share and plant capacity.

A typical scoring of organization's Competitive Position would be as illustrated below:

Factor	Weightage	Rating (1 to 10)	Score
1) Market Share and Capacity	20%	7	1.4
2) Growth Rate	10%	7	0.7
3) Location and Distribution	10%	5	0.5
4) Management Skill	15%	6	0.9
5) Work force Harmony	20%	7	1.4
6) Technical Excellence including Product and Process Engg.	20%	8	1.6
7) Organization Image	5%	8	0.4

The Industry Attractiveness Index is then plotted along the vertical axis and divided into low, medium and high sectors. Correspondingly, the Competitive Position is plotted along the Horizontal axis divided into Strong, Average and Weak segments. For each business in the portfolio, a circle denoting the size of the industry is shown in the 3 x 3 matrix grid which corresponds to the organization's market share as shown in Figure 13.3.

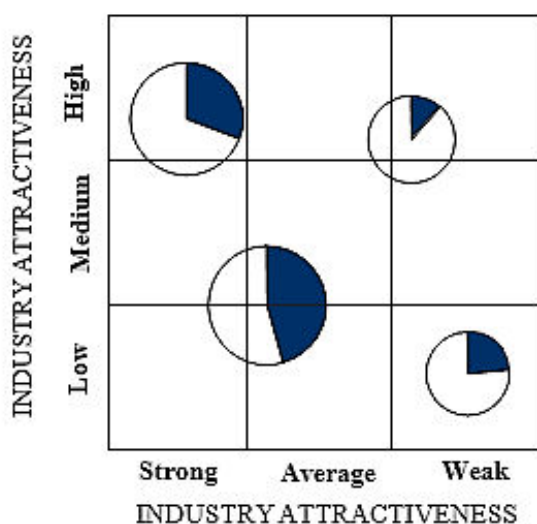


Figure 13.3: GE's Business Planning Matrix

GE rates each of its businesses every year on such a framework. If Industry's Attractiveness as well as GE's Competitive Position is low, a no-growth red stoplight strategy is adopted. Thus, GE expects to generate earnings but does not plan for any additional investments in this business. If for a business the Industry Attractiveness is medium and GE's Competitive Position is high, a growth green stoplight strategy is evolved for further investment. But if a business has high Industry Attractiveness Index and low GE's Competitive Position, this is branded as yellow stoplight business that may be moved either to growth or no growth category. Such grids are developed at different managerial levels. The final strategic decisions are made by GE's Corporate Policy Committee comprising the Chairman, the Vice-Chairman and Vice-Presidents of Operational areas, including finance.

Shell's Directional Policy Matrix

As in the GE's approach, the Business Prospects and Competitive Capabilities are plotted in Shell's Directional Policy Matrix. The three-by-three matrix as shown in Figure 13.4 identifies different strategies for each grid sector. These are explained in Table 13.2.

SECTORAL PROSPECTS	Attractive	Leader	Try Harder	Double or Quit
	Average	Leader	Custodial	Phased Withdrawal
	Attractive	Growth	Phased Withdrawal	Disinvest
		Strong	Average	Weak
		UNIT'S COMPETITIVE POSITION		

Figure 13.4: Three-by-three Matrix

Table 13.2: Strategies for different grid sector

Strategy	Business Prospects	Competitive Capability	Recommended Strategies
1. Leader	High	Strong	High priority with all necessary resources to hold high market position.
2. TryHarder	High	Medium	Allocate more resources to move to leader position.
3. Doubleor Quit	High	Weak	Pick products likely to be future high flyers for doubling and abandon others.

4. Growth	Average	Avg.Strong	May have some strong competition with no one organization as leader. Allocate enough resources to grow with market.
5. Custodial	Average	Average	May have many competitors, so maximize cash generation with minimal new resources.
6. Phase Withdrawal	Low	Average	Slowly withdraw to recover most of investments.
7. Cash Generation	Low	Strong	Spend little cash for the expansion, and use this as a cash source for faster growing.
8. Disinvest	Low	Weak	As sets should be liquidated as possible and invested elsewhere.

While using the above analysis, Shell realized that the various zones were of irregular shape, sometimes with overlapping boundaries.

PIMS Model

A programme for the Profit Impact of Market Strategy (PIMS) was started at General Electric, and was later used by the Strategic Planning Institute. The PIMS programme analyses data provided by member companies to discover 'general laws which determine the business strategy in different competitive environments producing different profit results'.

Unlike the earlier approaches using judgment for multidimensional factors, the SPI uses multidimensional cross-sectional regression studies of the profitability of more than 2,000 businesses. It then develops an industry characteristic, Business Average Profitability, and compares it with the performance in the concerned organization. This model uses statistical relationship estimated from past experience in place of the judgmental weightages assigned for the importance of different factors behind Industry Attractiveness and Competitive Position in previous approaches. This scientific objective approach has been criticized that the analysis relationship in it is based on heterogeneous population, i.e., different types of business, taken at different time periods.

Profitability is closely linked with market share. A 10 percent improvement in profitability is linked with 5 per cent improvement in Return on Investment. This has since been rationalized by a number of arguments, such as 'the Experience Curve Effect' which implies reduction in average cost with increase in accumulated production. The larger organization can use better quality management, and thus can exercise greater market power.

Arthur D. Little Organization's Matrix

Arthur D. Little Organization's matrix links the stages of the product life cycle with the business strength. On the vertical axis, the businesses are classified with respect to their business strength: Weak, Tenable, Favourable, Strong, or Dominant. Along the horizontal axis four stages in the life-cycle, Embryonic, Growth, Mature and Decline are marked as shown in Figure 13.5.

INDUSTRY PRODUCT LIFE CYCLE

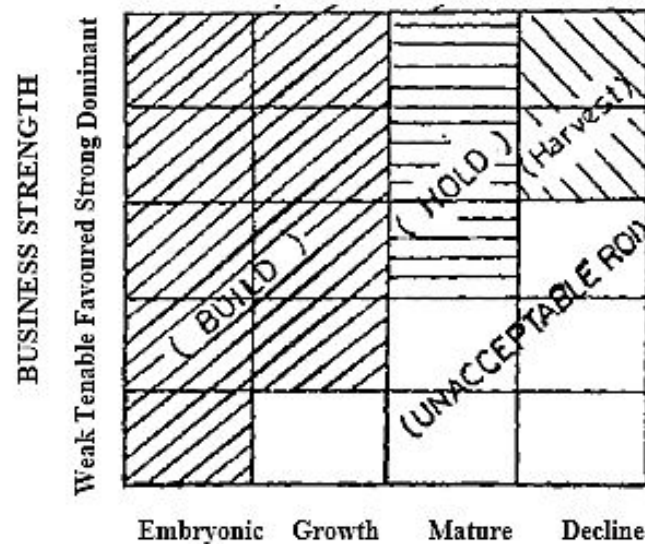


Figure 13.5: Arthur D. Little Co.'s Matrix

In the Embryonic and Growth stages, the businesses are recommended for Build strategy, except when the Business Strength is weak. For Mature stage businesses with dominant to favourable strength, HOLD Strategy is recommended. Harvest strategy is proposed for businesses in Decline stage, with Strong or Dominant position. For weaker businesses in Mature/Decline stage unacceptable ROI is marked.

Hofer's Product/Market Evolution Matrix

Charles Hofer has proposed a three-by-five matrix where businesses are plotted in terms of their product/market evolution and the competitive position. Relative sizes of industries are shown by circles wherein in the market share of the organization is shaded as shown in Figure 13.6.

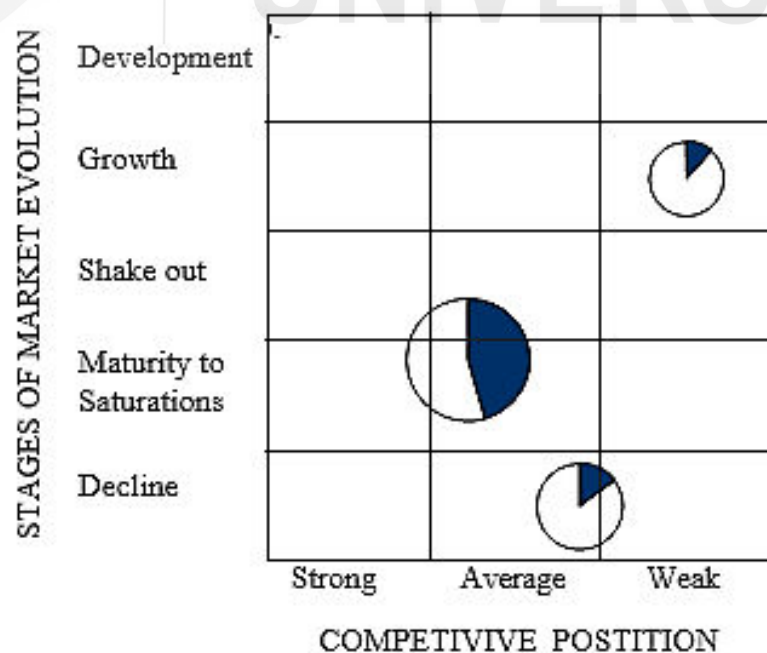


Figure 13.6: Hofer's Market Evolution

- A business in the Development or Growth stage has a potential to be a Star. If the market share is large in these growth oriented stages, more resources must be invested to develop competitive position. But if market share is low, a strategy to improve the same must be developed. If the industry is relatively small and market share is low despite high growth stage, management must consider divesting and redeploying resources in other more competitive businesses.
- A business in the Shake-out or Maturity stage has a potential to be a Cash Cow. Investments could be made to maintain high market share.
- A business in Decline stage with a low market share would be a Dog business. Though in the short run it may generate cash, in the long run, however, it should be considered for divestment or liquidation.

Activity 3

Search information of any diversified enterprise and gather information on its portfolio. Give your comments.

.....

.....

.....

.....

13.4 QUALITATIVE FACTORS

Measuring in organizational performance is one of the important parts of strategy evaluation process. It consists of the qualitative as well as quantitative aspects. We have already discussed the quantitative measures in unit on control. Here, we will stress upon the qualitative factors as a criteria for performance measurement.

Basically the qualitative factors constitute human factors. According to Seymour Tilles six qualitative questions are useful in evaluating strategies. They are:

- 1) Is the strategy internally consistent?
- 2) Is the strategy consistent with the environment?
- 3) Is the strategy appropriate in view of available resources?
- 4) Does the strategy involve an acceptable degree of risk?
- 5) Does the strategy have an appropriate time framework?
- 6) Is the strategy workable?

Some additional factors also have an impact on strategy evaluation. They can be:

- 1) How good is the organization's balance of investments between high-risk and low-risk projects?

- 2) How good is the organization's balance of investments between long-term and short-term projects?
- 3) To what extent are the organization's alternative strategies socially responsible?

There can be many more such questions which can have an impact on strategy evaluation.

After assessing all these questions, the final step is to take corrective actions to reposition the organization. This is necessary to adapt to the changing conditions and be able to face the competition.

13.5 BALANCED SCORE CARD (BSC)

Any organization, be it private or public, uses certain parameters as a tool for performance measurement. This is important to incorporate suggestions thereby working on a continuous improvement process, in turn evaluating the strategy so as to transform it into action. This section gives you an insight into one of the tools, i.e. Balance Score Card (BSC) to measure the performance of a business thereby evaluating the strategy. Here, we are going to look into this aspect of performance measurement in little detail.

Performance measures are said to be the indicators of success and form a major part of any organization. These indicators should be such that they are understood by all levels of the organization and help in achieving the specific objectives of the organization. Each organization has its own set of performance measurement framework. Let us now discuss the concept of BSC and how it can help an organization in performing effectively.

History

1990s saw the emergence of strategic management as a whole new concept. In the same time period a very new approach to it was developed by Dr. Robert Kaplan (Harvard Business School) and David Norton (Balance Score and Collaborative) and named it as 'Balanced Scorecard'. According to them, it provides a clear prescription as to what companies should measure in order to 'balance' the financial perspective.

The BSC is a **Management system** that enables organizations **to clarify their vision and strategy and translate them into action**. It provides a feedback around both the internal business processes and external outcomes so as to improve the strategic performance and results continuously.

According to Kaplan & Norton "The balanced scorecard retains traditional financial measures. But financial measures tell the story of past events, an adequate strong for industrial age companies for which investments in long-term capabilities and customer relationships were not critical for success. These financial measures are inadequate, however, for guiding and evaluating the journey that information age companies must make to create future value through investment in customers, suppliers, employees, processes, technology, and innovation." It is important to note that according to BSC we view the organization from four perspectives and they are:

- The Learning and Growth perspectives
- The Business Process perspective
- The Customer perspective
- The Financial perspective

The learning and growth perspective includes employee training and corporate cultural attitudes which are related to both individual and corporate self-improvement. The business process perspective refers to paternal business processes. This includes the strategic management process. The customer perspective, as the name suggests, aims at satisfying the customers' needs and wants as the customer satisfaction is one of the performance indicators for any organization.

The last perspective, i.e., the financial perspective relates to the handling and processing of financial data. Figure 13.7 can be the diagrammatic representation of BSC for an organization.

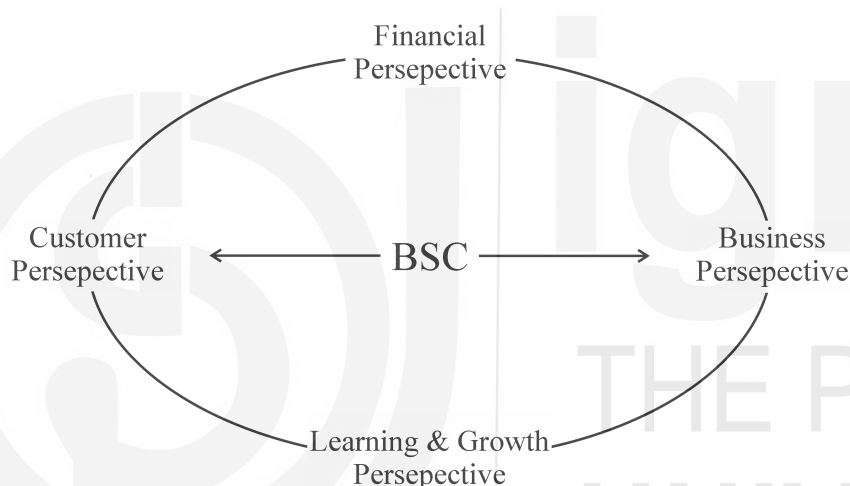


Figure 13.7: Balanced Score Card

Let us understand this concept with the help of an illustration.

Illustration: The business of enterprise is the production and sale of a local community newspaper. The main focus is on cost control and reduction, low levels of wastage and high levels of output. Interpersonal relationships are the key to growing revenue through advertising sales where the client can expect a well-targeted and relatively low-cost entry into the local marketing channels. The following is the BSC for X enterprise.

Financial Perspective		Customer Perspective	
CSF	Measures	CSF	Measures
Maintain low Overheads Shared computer facilities Flexible credit arrangements	Cost Ratios Asset Ratios Efficiency Ratios	Positive one-on one relationships with core advertisers	Number of sales% of available space sold

Business Process Perspective		Learning and Growth Perspectives	
CSF	Measures	CSF	Measures
Home Based Operations Rapid production e.g., Desk top Publishing	Measured in deadlines met and units produced – print run	Flat organizational structure High capacity utilization Efficient and cost effective information systems	# of processing errors, % of raw material wastage Time to response

CSF: Critical Success Factors

In short we can say that BSC is a strategic performance management system for the organization. It is not only a measurement tool but is also a communication tool to make strategy clear to all working in the organization and tries to balance the financial and non-financial aspects of the organization. Therefore, BSC is all about doing right thing at right time, but differently.

13.6 STRUCTURE FOR EVALUATION

For an effective implementation of strategy, it is necessary that someone is made exclusively responsible for carrying out the operations. Responsibility centres, therefore, may be created for achieving the objective of the organization following the selected strategy. The responsibility centres should have full freedom to take operational decisions relevant to their businesses. To an extent the responsibility centres will be restricted in taking decisions relating to functional policies as those decisions will not be within the jurisdiction of them. Responsibility centres may be of several types. In a profit oriented organization, there could be profit centre, there could be revenue centres or there could be expense or cost centres.

Profit centre managers are responsible for profits. They have full freedom to decide their level of sales, margins and production, what to make and what to buy, etc. At times, however, they do not have jurisdiction over financial policies (sources of financing) and basic personnel policies. The revenue centre heads are held responsible for generating the revenue (within the approved costs) and cost centre heads are responsible for a certain level of production or activities.

In the functional structure the only person who can be held responsible for profits is the chief executive, since the very next level below (i.e., the functional heads) does not have operational jurisdiction over issues related to other functional areas (but which influence profits all the same). Functional structure of the organization can thus have revenue and expense centres. In divisional structure the divisions will have most of the key operational decisions under their jurisdiction. Hence they can have profit centres for the success of strategy. The structure, thus, facilitates keeping of records for managerial accounting (so crucial for strategic decisions and strategy evaluation), and taking up/divesting a new product/ business. The most appropriate structure for strategy of growth through diversification or expansion is to create profit centres in the form of divisional structure. Divisional structure also facilitates grooming of functional executives as general managers, although it dilutes the functional specialization to some extent. The holding organization-subsidiary structure also provides similar

advantages from evaluation and control point of view; though it limits the scope of business portfolio management as different companies may be catering to different businesses.

The product divisional structure does not provide any significant advantage for growth through expansion in the same business or through (backward/forward) vertical integration. It is so because little flexibility is available to the divisions involved in the intermediate stages of production and all of them stand or fall together with changes in environment. Indeed it may be more appropriate in such cases to make the marketing divisions as revenue centres and production divisions as expense centres. The situation may be different if the intermediate product lines too have a significant market of their own. In such cases, making all such divisions as profit centres may be advisable.

Activity 4

What kind of responsibility centres exist in your organization? If you were given a free hand, what responsibility centres you would have created? Justify?

.....

.....

.....

.....

.....

13.7 EVALUATION SYSTEM IN A MULTI-BUSINESS ORGANIZATION

The identification of key success factors and their exact trend values is a complex process because of inter-business unit transfers of goods and services. Often these transfers take place at price levels which might suppress the true profitability of the supplying division. In such cases transfer price adjustments are carried out for the purpose of fair evaluation of each unit.

In a multi-product/multi-business organization, having several divisions as profit centres, there may be several products/components which are manufactured and sold by one division and at the same time required by others for their product/business. In such cases a system of transfer pricing needs to be developed for transfer of products/ components from one division to another, otherwise a situation may arise when two divisions may take decisions which may be against the overall interest of the organization. For instance, take two divisions A and B as profit centres. Division A produces a component which is a monopoly item and can fetch a margin as high as ₹ 30. The component price is say ₹ 100. Division B needs this component for one of its products. However, if it gets it at a price of ₹ 100, it cannot earn any profit on its product. Division A is not prepared to reduce its price to ₹ 85 as it cuts its margin by ₹ 15 to give 10% return on sales to Division B. Division B is left with two options to ensure 10% cut off return for its operations, either to drop the product or invest in facilities. The minimum size of facilities is far in excess of the requirements of the product in

Division B, hence it will have to sell in open market. The prices in that case are likely to fall to ₹ 75 per piece. Division B may also not like to divert its energies to sell the component separately. It will, therefore, decide to drop the product. The actions of Divisions A & B in maintaining profitability of their respective divisions thus lead to loss to the organization as a whole on the margin that was available to it on product B, if only Division A had reduced the price a bit.

Similar would be the case if Division A has created capacity to meet the requirements of Division B. However, at a later stage, a situation of glut appears and the other suppliers resort to heavy price cutting, and B decides to purchase from open market at a price which A cannot afford to supply without running into losses. The situation may be even more damaging to the organization, if the price reduction by the other supplier was to force some of the manufacturers (like Division A) to close the manufacturing facilities for the component and to rise prices again after the closures. Not only will the organization as a whole but even Division B be a loser.

It would be realized that there are two issues involved in situations of transfer pricing. Firstly, the sourcing decision, i.e., whether the product is to be bought/sold by a division internally or externally. In view of profit centres as independent responsibility centres, normally the divisions should be allowed to decide it themselves. But a situation may arise when the intervention of top management may be necessary to give sourcing decisions to ensure that buying/selling by divisions is in the interest of the organization. The second question is what should be the (transfer) price for the transfer of goods from one division to another.

It should be remembered that the purpose of transfer pricing is not to encourage inefficient operation by dictating a transfer price that will fetch a profit, but to ensure a fair price to the concerned divisions in the absence of an open and free competitive market price. That unifies the interests of the divisions with the interest of the organization. Thus, whenever market place prices are available and when the divisions can meet all their requirements of buying and selling there may be no need of intervention. Indeed even when these conditions do not prevail, the level of inter-division transfer may not be significant or no intervention may be necessary/ advisable.

13.8 CHARACTERISTICS OF AN EFFECTIVE EVALUATION STRATEGY

There are certain basics which should be followed for making the strategic evaluation effective. These characteristics are as follows:

- 1) The activities of evaluation must be economical.
- 2) The information should neither be too much nor too little.
- 3) The control should neither be too much nor too less. It should be balanced.
- 4) The evaluation activities should relate to the organization's objectives
- 5) It should be designed in such a manner so that a true picture is portrayed.

There can be many more such requirements. Large organizations require a more elaborate system than the smaller ones.

Think of more such characteristics of an effective evaluation strategy and list them.

.....

.....

.....

.....

.....

13.9 SUMMARY

This unit discusses the different concepts of strategy evaluation. The effort has been to make you understand the qualitative issues of evaluation system and the importance of portfolio analysis in strategy evaluation. Portfolio analysis is an important task of a corporate strategist. It provides a framework for analyzing the mutual compatibility of diverse operations of an organization. Balanced score card is one of the methods to measure the performance of the organization. There are many such methods which help in evaluation system. The crux of the unit is to understand the concept of strategy evaluation as a whole.

13.10 KEY WORDS

- Balanced Score Card** : A management system that enables organizations to clarify their vision and strategy and translate them into action.
- Evaluation Process** : The control mechanism, which helps in taking corrective actions.
- Portfolio analysis** : One of the methods to assist managers in evaluating the strategy.
- Qualitative Factors** : These are the human factors used for evaluation process.

13.11 SELF-ASSESSMENT QUESTIONS

- 1) What is the importance of structure for the evaluation of strategy? What are the advantages of profit centres?
- 2) What is the purpose of transfer pricing? What are the merits and demerits of transfer pricing?
- 3) Discuss the importance of the Balanced Score Card in the present context.
- 4) Discuss the application of portfolio analysis.
- 5) What basic considerations have to be kept in mind while balancing portfolios?

13.12 REFERENCES AND FURTHER READINGS

Anthony, R. N. & Govindarajan, V. (2014). *Management Control Systems*. United Kingdom: McGraw-Hill Education.

Brown, M. G. (2007). *Beyond the Balanced Scorecard: Improving Business Intelligence with Analytics*. United Kingdom: Taylor & Francis.

Byars, Lloyd. (1987). *Strategic Management: Planning and Implementation, Concepts and Cases*. New York: Harper & Row Publishers.

David, F. R. & David, F. R. (2017). *Strategic Management: A Competitive Advantage Approach, Concepts and Cases*. United Kingdom: Pearson.

Kishor, R. M. (2016). *Strategic Management* (2015 ed.). Delhi: Taxmann publication.

Scholes, K., Ambrosini, V. & Johnson, G. (1998). *Exploring Techniques of Analysis and Evaluation in Strategic Management*. United Kingdom: Prentice Hall Europe.



ignou
THE PEOPLE'S
UNIVERSITY